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27 July 2023

ESO Response to the Inflexible Offer Licence Condition Statutory Consultation.

Dear Luke

Thank you for the opportunity to respond to your Inflexible Offer Licence Condition Statutory Consultation.

Who we are

As the Electricity System Operator (ESO) for Great Britain, we are in a privileged position at the heart of the energy system, balancing electricity supply and demand second by second.

As the UK moves towards its 2050 net zero target, our mission is to drive the transformation to a fully decarbonised electricity system by 2035, one which is reliable, affordable, and fair for all. We play a central role in driving Great Britain's path to net zero and use our unique perspective and independent position to facilitate market-based solutions to the challenges posed by the trilemma.

Our transformation to a Future System Operator (FSO) is set to build on the ESO's position at the heart of the energy industry, acting as an enabler for greater industry collaboration and alignment. This will unlock value for current and future consumers through more effective strategic planning, management, and coordination across the whole energy system.

Our key messages

We are supportive of a licence condition which inhibits excessive benefits being achieved in the Balancing Mechanism (BM). We broadly agree with the changes made to this final proposal and whilst all elements of our prior response have not been adopted, we believe significant concerns have been addressed.

Across November 2022 to March 2023 we have observed the market behaviour change in instances which may previously have been captured by this condition, with a £199M decrease in observed costs¹ from the strategy of using a unit's inflexibility to achieve long duration balancing market actions at high prices, compared to the same period in the previous year. This cost reduction is demonstrated as resulting from changes in prices for similar energy scarcity conditions.

Overall, ESO view this as a required condition to reduce instances of excessive benefits being achieved through inflexibility.

Views on changes made:

- Whilst our control room makes highly pressurised decisions every day, removing the incentive for late notice significant changes which further pressurise decision making and remove alternative options is a welcomed change. This condition achieves this objective and allows for appropriate consideration of a greater range of commercial and technical options to optimise for costs.

¹ <https://www.nationalgrideso.com/document/281776/download> Winter Balancing Costs Review

- We do not believe that there are any reasons units should seek excessive benefits from a BM action but acknowledge that the restriction to periods of within day changes to physical notifications (PNs) enables more commercial and risk mitigation strategies. Whilst ESO continues to believe that the condition may be more effective if it always applied where a PN was 0MW, the current wording is expected to reduce instances of units excessively benefitting from their inflexibility.
- Re-introducing the condition of a within-day change to PN places the onus on ESO to detect these instances as this relies on data which only ESO presently have. ESO will identify and implement appropriate tests should the licence condition be approved.
- We understand the derivation of the Minimum Zero Time (MZT) requirement and the exemption of flexible units, but do not agree that a licence condition should exempt any unit category. This has potential to encourage units to change operating parameters to meet these criteria and given the techno-economic nature of these parameters it is possible that units may change their pricing behaviours in response.
- We acknowledge that units with low MZT cannot participate in the commercial strategy targeted by this licence condition and that their commercial positioning leads to a greater need to regularly revise their PN. Therefore, whilst we are concerned about exempting based upon a specific threshold, we do not believe this is a direct blocker.
- We believe that the changes to the definitions of excessive benefits now encompass a wider range of generator cost considerations and make an allowance for pricing of genuine scarcity alongside risk costs and long run marginal costs. This limits the expected impact of the licence condition on the wider balancing market.
- We are supportive of the statement that this licence condition could be reviewed should excessive costs due to inflexibility continue to be observed. This addresses concerns of instances of day ahead strategies being implemented or generating turbine configurations being used to excessively benefit from inflexibility.

Wider Market Considerations

- We believe the strategy of using a unit's inflexibility to achieve long duration balancing market actions at high prices revealed wider issues in how efficient balancing decisions must optimise over multiple hours when the Balancing Mechanism was not designed for such purposes. As part of our wider work in REMA, we are considering
 - whether introducing complex bid structures, whereby asset technical parameters are included in the market clearing process, would improve balancing outcomes, and
 - the extent to which moving to complex bidding would require moving away from the current self-dispatch mechanism.
- We are unaware of any conflicting commercial codes or impacted code change proposals by this licence condition.
- Through the licence condition consultation process itself, we have seen more moderate pricing responses to scarcity of operating reserve under most scenarios. Therefore, we think this is strong evidence to continue with this licence condition.

We look forward to engaging with you further. Should you require further information on any of the points raised in our response please contact Claire Thorpe-Morris, Market Monitoring Senior Manager at claire.thorpe-morris@nationalgrideso.com in the first instance. Our response is not confidential.

Yours sincerely

Craig Dyke

Head of National Control