

ENERGY MARKET MUST STAY ALERT TO MARKET ABUSE RISKS AS OFGEM TAKES ACTION

Significant financial penalty and redress payment signals Ofgem's intention to take strong action in respect of the manipulation of the wholesale energy markets, but leaves questions unanswered for market participants.

OFGEM'S SETTLEMENT WITH INTERGEN

On 15 April 2020 the UK's Office of Gas and Electricity Markets ("Ofgem")¹ [announced](#) that it had reached a settlement with companies in the InterGen group ("InterGen") in respect of allegations that InterGen had manipulated the UK's balancing mechanism on four days in 2016. InterGen was required to pay a penalty of £24.5m (reduced from £35m on account of InterGen's early settlement of the matter) in addition to c.£12.8m in restitution to recompense those affected by its conduct.

The balancing mechanism is one of the means by which the UK's Electricity System Operator, National Grid, can balance supply and demand in the UK's electricity market. At the time of the conduct, InterGen owned and operated three power stations in the UK, which secured significant payments from National Grid to generate in the balancing mechanism on the four days under investigation.

In order for generators to participate in the balancing mechanism, they are required to supply National Grid with their best estimate of expected future generation, in the form of physical notifications. Generators are also required to supply National Grid with various pieces of data regarding the operational characteristics of their power stations, known as dynamic parameters.

Ofgem found that physical notifications submitted by InterGen on the four days in respect of certain of its power stations did not represent InterGen's true expectation as to whether the power stations would be generating. Specifically, the physical notifications submitted suggested that the power stations would not be generating, which resulted in National Grid making payments to InterGen in the balancing mechanism to ensure that they would be, in circumstances where InterGen's staff knew or ought to have known that the relevant power stations would in fact be generating.

Key issues

- Ofgem is prepared to impose significant financial penalties for breaches of REMIT
- InterGen case may be indicative of a renewed risk appetite on the part of Ofgem to take on cases of greater complexity
- Settlement leaves questions unanswered as to the approach that balancing mechanism participants should take to the submission of dynamic data
- To the extent that Ofgem's regulatory expectations regarding dynamic parameters differ to current industry practice, other balancing mechanism participants will have a regulatory exposure on this point

¹ In exercising its enforcement functions Ofgem acts on behalf of the UK's Gas and Electricity Markets Authority. For the sake of simplicity, the authority will be referred to as Ofgem throughout this note.

Additionally, Ofgem found that one of the dynamic parameters submitted by InterGen, the stable export limit ("SEL") was on occasions submitted at a higher level than it should have been, solely with a view to receiving higher revenues from National Grid in the balancing mechanism. These higher revenues were achieved due to the fact that when purchasing power from InterGen in the balancing mechanism, the SEL represented the minimum level of power that National Grid would need to purchase in order for InterGen's power stations to generate.

LEGAL FRAMEWORK

InterGen's conduct was found by Ofgem to be a breach of the market manipulation prohibition found in Article 5 of the EU Regulation on Wholesale Energy Market Integrity and Transparency ("REMIT").

Ofgem also found the conduct breached the standard electricity generation licences held by each of the three power stations, which required the power stations to comply with the Grid Code. The Grid Code details the technical requirements for connecting to and using the National Electricity Transmission System. Among other things it requires that balancing mechanism participants use reasonable endeavours to ensure that data held by the Electricity System Operator is accurate and that dynamic parameters submitted reasonably reflect the expected true operating characteristics of the power station and are prepared in accordance with good industry practice. No separate penalty was imposed in respect of the licence breaches in light of the penalty levied under REMIT.

ISSUES RAISED BY THE SETTLEMENT

Physical notifications

The settlement highlights the need for generators to consider carefully when seeking commercial opportunities in the balancing mechanism whether physical notifications submitted can be said to represent a best estimate of expected future generation. This is particularly so when the physical notifications submitted do not correlate to contracted positions held, as was the case with InterGen, notwithstanding any plans to subsequently purchase electricity in the market to meet these commitments.

Ofgem has [previously](#) stressed that, whilst REMIT is not intended to interfere with the proper application of market forces, nor prohibit a rise in market prices reflective of scarcity in the market, Ofgem will take action under REMIT if it considers that misleading physical notifications have been submitted.

Dynamic parameters

One subject left unresolved by the settlement is the extent to which dynamic parameters submitted may reflect commercial considerations. Ofgem recognises in its findings that "*dynamic parameters may reflect commercial issues to a limited extent*" but no further guidance is given on the subject.

In InterGen's case, it was found that dynamic parameters submitted solely with a view to achieving higher revenues in the balancing mechanism were impermissible, as they did not reasonably reflect the true operating characteristics of the power stations. However, where the operational characteristics of power stations end and commercial considerations begin is by no means straightforward, and Ofgem's findings beg the question as to

where the line is drawn between legitimate commercial considerations and illegitimate ones.

With the rise of flexible generation in the UK, it seems fair to ask whether the Grid Code requirements concerning dynamic parameters have kept pace with the operational capabilities of modern power stations, and whether Ofgem's regulatory expectations regarding dynamic parameters are out of step with current industry practice. To the extent that there is a gap between Ofgem's expectations and industry practice, other generators will have a regulatory exposure on this point and, we observe, breaches of the market manipulation prohibition in REMIT may be criminally prosecuted.

OFGEM'S ENFORCEMENT APPETITE

Historically, Ofgem has been slow to take action in respect of REMIT breaches, and in this regard has lagged behind some of its European peers. Since Ofgem was given its powers in 2013 to investigate and enforce breaches of REMIT, it has only levied one other penalty in respect of a REMIT breach, which was a [penalty of £2.1m](#) against Engie Global Markets in respect of manipulation of the wholesale gas market.

Whether the significant penalty levied in the InterGen case represents a change in approach by Ofgem to REMIT enforcement remains to be seen, however, with Ofgem's board providing support [last year](#) for the imposition of higher penalties, and agreeing that it has a risk appetite for proceeding with cases that have greater complexity, it may be that the case is a sign of things to come from Ofgem.

Luke Tolaini and Matthew Lee at Clifford Chance LLP acted for InterGen in relation to Ofgem's investigation.

To learn more about Clifford Chance's experience of acting on regulatory enforcement matters, the topics covered by this briefing or REMIT compliance matters more generally, please contact those listed overleaf or your usual Clifford Chance contact.

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