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1st March 2012

Dear Ian

Transmission Constraint Licence Condition Guidance

Thank you for the opportunity to contribute to your Guidance associated with the proposed introduction of a Transmission Constraint Licence Condition. We would like to take this opportunity to thank you for the time your staff took to come and discuss the issues raised by the DECC proposed TCLC. Members found that session helpful. I trust that you and your staff have been able to accept our offer to visit a power station in order to assist Ofgem in its understanding of the day to day issues that arise whilst operating in a free market under self despatch operations. It is important that your guidance proposals are put into context with regard to the far reaching impact if introduced.

As stated in our response to DECC, members of the Association of Electricity Producers strive to ensure delivery of economic and secure energy supplies. As you are aware generators have an impeccable record of responding well in extraordinary circumstances in order to assist the System Operator in keeping the lights on. Our members agree that it is unacceptable that plant despatch decisions should knowingly create or exacerbate transmission constraints in order to create short term gains in the Balancing Market (BM) however the reception to the proposed DECC Licence conditions has been mixed. Whilst some members feel that there are sufficient safeguards in place via the Competition Commission and most recently the European provisions under Regulation on Energy Market Integrity and Transparency (REMIT), others believe that there may be merit in what DECC is trying to achieve with the introduction of this legislation, provided there are also some safeguards.

I have attached our response to DECC in Appendix 1 of this response and do not propose to rerun the views expressed. In addition I am aware that many of our members are taking the opportunity to respond to your consultation and will articulate their views without the need for me to repeat them here. I would

just like to take the opportunity via our AEP response to focus on the following observations with regard to the proposals within your TCLC Guidance:

Lack of up to date timely constraint information

We have recorded our concerns within our response to DECC with regard to the lack of timely information available to market participants in relation to ongoing long term and short term transient transmission system constraints. We can foresee a situation whereby, acting upon the information currently available to the generator, it may take action that inadvertently impacts on the effects of an ongoing transmission constraint that the generator is unaware of, because information about an ongoing transmission constraint is not currently provided to market participants. We believe that prior to any TCLC proposals being adopted there should be improvements made to the constraint information available to the market generally. Members would welcome the opportunity to work with Ofgem and National Grid to introduce improvements to the current information available to market participants relating to transmission system constraints. This could also potentially lead to innovative improved products introduced in future to relieve constraints.

Lack of clear definitions may lead to confusion

The list of definitions in Appendix 2 Paragraph 9 of your guidance document is rather limited in that it does not get to the heart of what Ofgem will deem to be 'excessive' behaviour. It would be helpful if Ofgem could expand its view as to the methodology to be applied?

Monitoring

The two paragraphs included on the process Ofgem intends to introduce to support monitoring compliance with the TCLC do not contain any reference to human or manifest error or actions that clearly do not reflect the generators normal practice? If system alerts built into the database that Ofgem intends to utilise for generator monitoring indicate activities outside of normal operations what does Ofgem intend to do with that information? Presumably early dialogue with the generator would be advantageous in order to ensure that this is not just an operator or manifest error.

Confidentiality

There is no clear reference to confidentiality of any Ofgem constraint related operations. This may be implied but has not been stated anywhere throughout the document. Early clarification regarding the treatment of ongoing investigations would be much appreciated.

Interaction with other market developments over the potential seven year life of this condition

Members have questions about the length of time the TCLC will be in operation, currently proposed to be 5 years or 7 if extended. If introduced it would seem prudent that there be an annual review of the appropriateness of

this licence condition. Such a review would inform DECC and the wider market about its effectiveness and whether it remains fit for purpose. Could we have clarity on how the relevance of this proposal will be monitored and whether we will receive regular updates on what information Ofgem has reviewed over the period of the licence condition and reported to DECC and the Authority? Monthly updates would be preferred with a review to publish more or less frequently after the first quarter of operation should DECC decide to go ahead with its proposals.

Finally we would note that there is mention of the sunset clause in the proposed TCLC within your guidance document but no information about its suitability with regard to any interaction with ongoing market developments. For example, since publication of the proposals REMIT has been introduced. Now that the details of this EU legislation are known this raises the question of whether there is still a requirement to introduce the TCLC and if so which gaps in the REMIT legislation DECC/Ofgem aiming to plug with TCLC.

If you would like to discuss any of these comments further please contact Barbara Vest, Head of Electricity Trading on 07736 107 020.

Yours sincerely

David Porter
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By Email



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1st March 2012

Dear Sir/Madam

Transmission Constraint Licence Condition

Thank you for the opportunity to contribute to your consultation on the potential introduction of a Transmission Constraint Licence Condition (TCLC) applicable to Generators. We would like to take this opportunity to thank you also for the time that your staff took to come and discuss the issues raised by your proposal. Members found that session helpful. I hope that your staff have been able to accept our offer to visit a power station in order to assist DECC in its understanding of the day to day issues that arise whilst operating in a free market under self despatch operations. It is important that your proposals are put into context with regard to the far reaching impact if introduced.

Members of the Association of Electricity Producers strive to ensure delivery of economic and secure energy supplies. Generators have an impeccable record of responding well in extraordinary circumstances in order to assist the System Operator in keeping the lights on. Our members agree that it is unacceptable that plant despatch decisions should knowingly create or exacerbate transmission constraints in order to create short term gains in the Balancing Market (BM), however the reception to your proposals has been mixed amongst our membership. Whilst some feel that there are sufficient safeguards in place via the Competition Commission and most recently the European provisions under Regulation on Energy Market Integrity and Transparency (REMIT) others believe that there may be merit in what DECC is trying to achieve with the introduction of this legislation, provided there are also some safeguards.

There is currently a real need for an improvement in the availability of timely information regarding constraints. To put this into context, members do not have the same breadth of information available to them as National Grid and are blindsided to the full impact of their individual actions on the operation of the whole transmission network. It is important that generators are given the opportunity to check that actions cannot be construed as being uneconomic. With the current limitations of available timely data it is impossible to tell whether a decision to despatch has worsened a constraint. Proposals to enhance the availability of constraint related information have previously been discussed with National Grid but have not been successful to date. We would be happy to participate in the development of enhancements to the constraint related information currently available.

Should there be a system introduced to improve the availability of timely market wide constraint related information then it is important to be clear about the Ofgem approach to implementation of the conditions. As currently outlined Ofgem is proposing something far too subjective an approach which may deter effective participation in the BM. The TCLC should be obvious in its application which can be achieved by the setting of clear, pre-defined, "triggers" for each of the prohibitions contained within the TCLC.

In conclusion whatever the outcome of your deliberations around the introduction of this proposed licence condition we would encourage improved transparency around the timeliness and breadth of information available to the market with regard to transmission constraints. We attach in Appendix 1 our answers to the specific questions posed within your consultation and in Appendix 2 our response to Ofgem on its TCLC Guidance document.

If you would like to discuss any of these comments further please contact Barbara Vest, Head of Electricity Trading on 07736 107 020.

Yours sincerely

David Porter
Chief Executive
Association of Electricity Producers
By Email

Consultation on the Transmission Constraint Licence Condition (TCLC)

CIRCUMSTANCE 1

Q1. Does the prohibition set out under circumstance 1 of the licence condition adequately address the problem of generators profiting from actions in the BM as a result of the exacerbation or creation of transmission constraints?

Members of the Association of Electricity Producers strive to ensure delivery of economic and secure energy supplies. Generators have an impeccable record of responding well in extraordinary circumstances in order to assist the System Operator in keeping the lights on.

In order to explain our position on this issue it is important to put into context the lack of control any generator may have during exposure to a Transmission Constraint which does not necessarily occur because a generator deliberately creates it. A Transmission Constraint can occur for a number of reasons outwith the control of an individual generators party. Of particular concern is the contribution made through the 'on the day' activity of all transmission system users, planned or unplanned, be they the Transmission Operator, System Operator, Generators, Demand or the forces of nature itself. In addition the activities that feed into one transmission constraint occurrence may never be replicated because of the dynamic activities of all players and split second decisions made by the many contributors to the event.

Generator Despatch involves taking into account a wide variety of contributory elements 'On the Day'. Such as:

- The optimisation of individual contract obligations. This may be those via bilateral counterparties or with National Grid who could exercise reserve or ancillary service options for example as and when required;
- Individual plant maintenance or plant resilience;
- Fuel quality combined with the time of day/month interlinked with the expected delivery of additional fuel or having to burn poor quality fuel before it degrades further;
- Individual staff preferred mode of operation;
- or whether single site or part of a portfolio of generation and/or supply.

The list goes on.

In addition there are activities and contractual arrangements which are outwith the control of generators affected by this proposed Condition. Such as, for

example, the activities of the three Transmission Operators and the System Operator, who will be mindful of the interaction with various aspects of their individual incentive schemes. To be clear the aforementioned are incentivised to minimise the impacts of constraints, one route being to enhance transmission investment and the other to commercially negotiate additional, flexible and innovative ancillary services.

To ensure that every feasible option has been taken into account, with appropriate weighting and the recognition of all relevant activity on the day for this particular provision will be a mammoth task. Care must be taken to ensure that a fair assessment of the role that any one generator might play in the overall scheme of events and will therefore be extremely subjective.

Given the above, we believe that for the circumstance 1 prohibition to work effectively there must be a pre-defined “trigger” which would be used to signal when Ofgem is to begin an investigation. This approach would provide a high degree of transparency and certainty for all parties. The trigger would not in itself indicate a breach of the TCLC but would simply highlight a circumstance which warrants further investigation by Ofgem. As an example the trigger could be based on a materiality threshold which could then be applied to the automatic alert built into Ofgem’s database.

For the avoidance of doubt, we interpret this condition as one which is aimed at Licensed generators and will not therefore apply to unlicensed generators. It must therefore be recognised that as a constraint on the transmission system may be for, say 1MW, 10MW or 100MW and that, as we understand it an unlicensed generator could have caused the constraint, but the actions of the licensed generator will be potentially subject to investigation / enforcement.

Q2. Is this approach likely to have any unintended consequences on behaviour in the electricity market?

It may be that generators become more conservative in their response ‘on the day’ for fear of being misrepresented as manipulative and this may subsequently adversely impact security of supply.

We believe that if clear and pre-defined triggers are not set out in the licence condition or in Ofgem’s guidance, then there is a risk of numerous or non-material investigations being undertaken. Such an approach would distort the balancing market and over time, weaken investment signals both in the system and individual plant. This could potentially result in increased constraints, reduced plant efficiency and flexibility and ultimately plant closure. It is key that where a licensee has a flexible portfolio they must be able to realise the profits to reward this flexibility, or else the GB generation market will become increasingly inflexible at a time when it is short in flexibility.

CIRCUMSTANCE 2

Q3. Does circumstance 2 adequately address the issue of excessively

low or negative bids during periods of transmission constraint?

This issue has been one which both generators and National Grid have been working hard to resolve and we have seen massive improvements in recent months. Connect and Manage has been successful in facilitating the early connection of low carbon plant waiting to come onto the system with many of the operators involved being new to the industry. In addition there are cases where they are from a separate division of some of the already established companies and as such, quite rightly, have not shared the detail of commercially sensitive contractual relationships. Their experience in the market has been in many cases limited.

Together with National Grid, Trade Associations like ours, Renewable UK and Scottish Renewables have facilitated a massive education process in order to explain some of the benefits of participation in the Balancing Mechanism alongside some of the downside too. In addition the Grid Code Review Panel agreed arrangements which saw the expansion of Electronic Despatch capability into many sites. A major exercise has been undertaken to explain the negative impact of seriously low sleeper bids and in response we have seen many existing occurrences removed. The dialogue continues.

We believe that it may be too soon to look to such a serious remedy for an issue which the industry is working hard to resolve voluntarily.

However if this change is to be implemented, then in our view a pre-defined “trigger” for circumstance 2 should be set would be used to signal when Ofgem is to begin a formal investigation. This approach would provide a high degree of transparency and certainty for all parties. As stated above the trigger would not in itself indicate a breach of the TCLC, it would simply highlight a circumstance which warrants further investigation by Ofgem.

In respect of circumstance 2 the trigger must be clearly defined in order to be effective and provide licensees with a clear view on when they are likely to face investigation. If the circumstance 2 trigger or threshold is not defined, each licensee will be required to “take a view” on what it is, leading to industry confusion and misunderstanding. In our view, a simple and effective trigger would be to compare the volume weighted daily average accepted bid price for the plant concerned to the GB market volume weighted daily average accepted bid price (for the same technology), with a tolerance banding applied.

Q4. Is this approach likely to have any unintended consequences on behaviour in the electricity market?

It is possible that, at a time when we wish to attract significant additional investment in low carbon generation to the UK, that this additional market intervention could have a negative impact on potential investors and ongoing future investment in flexible plant which is necessary to support an increase in low carbon generation.

There is also the potential that ‘dampened’ Bid and Offer prices may distort

transmission network investment signals and reduce the attraction of BM participation and ultimately competition for balancing services resulting in increased costs for the System Operator.

CIRCUMSTANCE 3

Q5. Do respondents consider that since the passing of the Energy Act 2010 the market has developed in a way that may mean the proposed prohibition is no longer appropriate?

Association members are unclear why this particular proposal has been raised and why if required, it should only apply to generators as Intertrip contracts are bilaterally agreed between the generator and National Grid. If for some reason National Grid as party to the contract becomes concerned about elements of that agreement then it should not sign onto the terms and conditions being requested by the other party.

An Intertrip arrangement is not always the only solution to a particular constraint related issue. National Grid is incentivised with regard to the management of constraints and should be looking to introduce innovative cost effective products to be used alongside or in place of intertrips. Bilateral intertrip agreements are only entered into as an alternative to the potential acceptance of bids to resolve constraints in order to secure flows over across export constraint boundary. If bid prices are in some sense being regulated, is there a compelling reason to also regulate intertrips?

Q6. Does circumstance 3 adequately address the issue of excessively high arming fees for inter-trips?

Our member's views are split on whether the arming fee for intertrips should be included in the scope of the TCLC. Some believe that this is an issue to be addressed by the two parties to the bilateral intertrip agreement. The argument in support of non inclusion lies in an understanding of the difference between mandatory and commercial inter-trips, which licensees are under no obligation to offer to the SO. Some feel that it may be reasonable to cap mandatory inter-trip arming fees on a 'cost plus' basis, but not to place a similar cap on *commercial* inter-trip arming fees. The view being that to do so may remove any incentive on licensees to offer commercial inter-trip services, to the significant detriment of the market overall. Other members do not believe that there is a case to support inclusion of arming fees for inter-trip services within the scope of the TCLC at this time.

Those members who are supportive of arming fees being within the scope of TCLC would agree that in line with the proposed approach under circumstance 2, where licensees are allowed to make a *reasonable* profit on bids in the BM, licensees offering a commercial inter-trip service should be allowed to make a reasonable profit from doing so. However agreement on what the definition of '*reasonable*' is highlights the point of division and has led some members to believe that it may be appropriate to look more closely

at intertrip arming fees.

Q7. Is this approach likely to have any unintended consequences on behaviour in the electricity market?

Yes. The intertrip contract is a bilateral one between two parties with the information contained within it confidential to the two parties only. It is therefore difficult to benchmark against other intertrip contracts. To impose a restriction on generators without full disclosure of the values involved could ultimately constraint the debate here and stifle innovation or flexibility.

If arming fees associated with intertrips is included in the TCLC then the unintended effect may lead to the removal of commercial inter-trip services from the market, leaving the SO with no viable alternative but to constrain plant on and off via the more costly BM market. This, in turn, would lead to higher costs and increased BSUoS, exactly the opposite outcome to that intended.

OTHER CIRCUMSTANCES

Q8. Are there any other circumstances in which generators can derive excessive profits during a period of transmission constraint that should be addressed in the licence condition? Please provide evidence to back up your response.

There are several other routes that are currently available which could be used where a case of proven abuse has been identified. The primary route within the UK is via the Competition Commission. The recently introduced Regulation on Energy Market Integrity and Transparency (REMIT) is the EU route. A further market intervention by Ofgem to cap bid or offer prices in the Balancing Mechanism (BM) could result in generators moving away from participation in the BM which is difficult to reconcile at a time when the industry is trying to encourage many of the newer players to try to become involved.

For the TCLC to work effectively and avoid unintended and detrimental consequences, clear and pre-defined “triggers” need to be set for each of the prohibitions the TCLC.

In addition significant improvements in the timely information regarding transmission system constraints must be made available pre event and not post as now.

Q9. Should the licence condition also cover excessive benefits from offers in the BM beyond the prohibition in circumstance 1? Please provide evidence to back up your response.

No. This is a separate issue

Q10. What are your views on the evidence presented in the attached impact assessment? Do you have any additional evidence or arguments that could inform our view of the costs and benefits of different options for implementing this licence condition?

No.