

Ian Marlee
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Ofgem
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1 March 2012

Dear Ian

Transmission Constraint Licence Condition (TCLC) Guidance Consultation

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, combined heat and power plants, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including both residential and business users.

EDF Energy welcomes the development of the TCLC. We believe that if it is successfully applied then it will reduce the balancing costs for which consumers ultimately have to pay. We make the following comments in support of our view:

- We believe that the TCLC will actually enhance the price signals within the Balancing Mechanism (BM). This is because the TCLC will require generators to make a more considered assessment of their willingness to participate in the BM.
- We think that DECC's Impact Assessment under-estimates the benefit of the TCLC:
 - The potential portfolio effect of profiting from both sides of the constraint could increase the benefit brought about by constraint gaming.
 - If the licence condition is not enforced, then it potentially weakens the deterrent faced by market participants from further exploitation of constraints.
 - The impact of wealth transfers between generators in the competitive process should not be ignored. The BM naturally has a redistributive impact for generators who are either in or out of balance. Constraint gaming distorts this process and allows an unfair competitive advantage to exist at times of constraint, where generators have increased headroom to price just below bids which will be tagged out of the process. Those bids which are tagged out will increase the *overall* costs of balancing the market as a whole.
- It is preferable for the System Operator to use the Balancing Mechanism (BM) to solve the problem of constraints, as it is a dynamic and cost reflective approach to the problem of balancing. In view of the evidence from historical operational experience EDF Energy supports the inclusion of inter-trips in the licence condition. This is because plant that is in a position to exercise market power can choose to exploit its position in either of the two markets. There is a risk that if the TCLC was only applied to the BM it could lead to inappropriate behaviour in the market for

inter-trips. We agree with the focus on arming, and would not want the TCLC extended to exercise fees.

The challenge for the TCLC will be in respect of the treatment such plant that does not have a readily identifiable set of input costs such as conventional plant has. For example, safety and operational characteristics may also need to be incorporated into bidding strategies and behaviours. It is incorrect to think that such plant does not incur costs over the short term. The proposed licence condition should take into account the technical capabilities of the plant in order to fully assess bidding behaviour in the BM. For nuclear plant, there are numerous issues that are considered when determining bidding strategy. This will include issues such as the “return to service profile”, safety case implications, as well as operational costs that may be incurred in participating in the balancing mechanism. Nuclear plant may return to service over a period of days for a number of safety and technical reasons. Therefore, the costs to the nuclear operator may appear to be in excess of that of a conventional plant that can return to full operation within a matter of hours (assuming there are no technical issues). We will still need a price signal for “unavoidable manoeuvres” which are outside the nuclear safety case. Furthermore, the longer term costs of maintaining the asset and the impact that any transient operating regime may have on the costs should be included in Ofgem’s assessment of bids.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact my colleague Dr Sebastian Eyre on 020 7752 2167 or myself.

I confirm that this letter and its attachment may be published on Ofgem’s website.

Yours sincerely,

A handwritten signature in black ink, appearing to read "D. Linford".

Denis Linford
Corporate Policy and Regulation Director

Attachment

Transmission Constraint Licence Condition (TCLC) Guidance Consultation

EDF Energy's response to your questions

Question 1: Do you agree with our interpretation of uneconomic dispatch?

We agree with the “excessive profit” prohibition of the licence condition and agree that this should be in the context of a dynamic approach which takes into account ramp up and ramp down costs.

When it comes to assessing nuclear or renewable plant which is not subject to the input costs listed in 2.14, the concept of economic dispatch cannot be defined purely in the short term for this type of plant. For nuclear plant, the “return to service profile” is the key cost that the operator will need to recover over and above the normal operating parameters of conventional plant. Furthermore, the long term impact on the asset life of the plant could actually be higher. This is important, as these costs are no less “economic” than input costs. We would request further clarification in the guidance on this issue.

Question 2: Is the use of “within-day” fuel and electricity prices to calculate generation profitability the most realistic approach?

We agree this would be the most sensible way of calculating profit for generators with variable input costs. However, this is by no means definitive and is instead a useful indication of profitability. For generators with variable costs, it would also be useful to consider the weighted average input costs for coal or gas (e.g. WACOG, WACOE). Since the enforcement is ex post, it should be possible to determine the exact accounting costs for the plant that were or were not running at the time of constraint.

For generators with little or no input costs it will be the opportunity cost and return to service profile and the lifetime costs which will define bidding behaviour. The “Within day fuel and electricity” prices identified by Ofgem in its assessment of bidding behaviour only for the time of the constraint will not cover lost revenue if the plant is offline for a number of days.

Question 3: What other costs, if any, should be included in our initial analysis of dispatch decisions?

We would add two other costs:

1. Impact on asset lifetime. This can occur if plant is taken on and offline, outside of normal maintenance schedules.

2. The opportunity cost of not generating if the plant is offline *after* the constraint period has ended. This is because the assessment of profit has to consider the time it takes to return the plant to service, given that the generator will be incurring a loss during this period.

Question 4: Are there any further important arguments that provide objective justification for uneconomic dispatch?

From our answer to question 3, we suggest two extra arguments:

1. Costs for return to service for plant with extended periods after the constraint period has ended;
2. Impact on asset lifetime and safety cases of participating in the BM at short notice.

In both cases we can clearly demonstrate loss.

Ofgem should also consider health and safety law as a legitimate justification for the way in which the operator utilises its plant.

Question 5: Are there any objective justifications cited above which should not be considered in our assessment?

No.

Question 6: Do you agree that the indicators outlined above are useful for Ofgem to consider when determining whether the bids are excessive or not?

We agree as far as the list goes. EDF Energy believes that an overall assessment of the technologies' capabilities is a prerequisite for understanding generator behaviour as outlined in our answers to questions 3 and 4. This is crucial in determining comparative benchmarks for profitability.

Question 7: Are there other factors or indicators that Ofgem should consider in interpreting this circumstance?

No.

Question 8: Are there any further important arguments that provide objective justification for seemingly high bids?

We would insist that Ofgem consider health and safety law that has a legitimate impact on the way in which the operator utilises its plant.

Question 9: Are there any objective justifications cited above which should not be considered in our assessment?

No.

Question 10: Do you agree with our definition of arming fees, and that this is the relevant price to capture under this circumstance?

To the extent that it is possible, EDF Energy believes it is preferable for the System Operator to use the BM approach to solve the problem of constraints, because it is a dynamic and cost reflective approach to the problem of balancing.

In the assessment of arming fees of different type of plant, Ofgem needs to consider the technical characteristics of the plant and in particular the time it takes to get back online. The policy cannot assume that generators will necessarily be pursuing an anti-competitive strategy if they are simply recovering legitimate costs associated with production.

Question 11: Do you agree that the indicators outlined above are useful for Ofgem to consider when determining whether inter-trip arming fees are excessive or not?

As previously stated we would add two other costs:

1. Impact on asset lifetime. This can occur if plant is taken on and offline outside of normal maintenance schedules.
2. The opportunity cost of not generating if the plant is offline *after* the constraint period has ended. This is because the assessment of profit has to consider the time it takes to return the plant to service, given that the generator will be incurring a loss during this period.

Question 12: Are there other factors or indicators that Ofgem should consider in interpreting this circumstance?

A comparison of arming fees in areas where there are no known constraints would be a useful benchmark.

EDF Energy
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