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Dear Ian,

## **Consultation on the Transmission Constraint Licence Condition Guidance**

Thank you for the opportunity to provide views on your consultation on the Transmission Constraint Licence Condition (TCLC) Guidance. This response is provided on behalf of National Grid Electricity Transmission plc (NGET) and is not confidential. National Grid owns and operates the high voltage electricity transmission system in England and Wales and, as National Electricity Transmission System Operator (NETSO) we operate the Scottish high voltage transmission system.

In the UK, our primary duties under the Electricity Act are to develop and maintain an efficient network and to facilitate competition in the generation and supply of electricity. Our activities include the residual balancing in real time of the electricity markets.

### **Summary**

The electricity market is currently undergoing unprecedented change through the increase in renewable generation connecting to the grid which in turn will pose a greater challenge for National Grid to balance the electricity transmission system. Following on from the government-directed Connect and Manage<sup>1</sup> regime, which aimed to improve grid access for renewable generation through advancing connection dates, it was expected that the costs incurred from managing constraints on the transmission system would increase. This was due to the requirement to facilitate the balancing of demand with increased generation connections on the transmission system in advance of wider reinforcement works being completed. However, in the longer term, the planned upgrades to the network should increase the capacity to facilitate the flow of electricity across key network boundaries and reduce the likelihood of constraints affecting the balancing of the system.

In addition to this, we have recognised that the increase in intermittent and inflexible generation on the system has at times exacerbated existing constraints resulting in higher constraint costs due to high negative bid prices, which has led us to publish a consultation to

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<sup>1</sup> <http://www.decc.gov.uk/assets/decc/Consultations/Improving%20Grid%20Access/251-govt-response-grid-access.pdf>

address these issues<sup>2</sup>. We are currently working with the industry to develop potential solutions and to impress on all generators the importance of participating actively within the Balancing Mechanism (BM) so that all available generation is readily accessible. Importantly, we believe that the TCLC is complementary to the existing work of addressing high negative bid prices and should incentivise generators to avoid giving rise to the circumstances set out in the licence condition. In any case, the TCLC should act to reinforce this work.

We note that this consultation provides detail on how the TCLC will be enforced but we do have some reservations as to how “excessive” prices will be defined, especially in the case of low bids in the BM and high arming fees for inter-trips. We would welcome some guidance that seeks to distinguish between an “excessive benefit” for the purposes of the condition from the notion of “excessive pricing” under competition law. For example, a value based approach to the setting of arming fees for inter-trips may not be considered as excessive if it can be demonstrated that there is significant value for the provision of the service. Clearly this approach could still expose consumers to prices that are significantly higher than the costs to the generator of providing the service. In this light we have made a suggestion to DECC in our response to its consultation on the drafting of the TCLC that the condition state that an excessive benefit should be judged on the basis of the benefit to the licensee, not the benefit to the System Operator of taking a particular action.

We believe that any breach of the licence should not impact the rest of the industry and suggest that consideration should be given to a possible post event adjustment of BSUoS charges and National Grid’s incentive scheme. This would ensure that parties are not penalised through the actions of others and would minimise the distortion to balancing charges.

Whilst we are supportive of the TCLC, we note these licence exempt generators will, by their nature, not be captured by the condition. We consider that this may enable certain generators to engage in precisely the kind of behaviour that the condition is aimed at prohibiting. As a result, we consider that the scope of condition should be widened to cover not only the licensee, but also its affiliates and related undertakings, and we have suggested some wording to DECC to achieve this.

The remainder of this response in the Appendix provides our thoughts in relation to the specific questions asked within the consultation document. We have also made a number of other suggestions for changes to the drafting of the condition to DECC. For your information, we are also copying our response to DECC to you. This sets out the proposed changes to the condition as an Annex.

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<sup>2</sup> Managing intermittent and inflexible generation in the balancing mechanism  
<http://www.nationalgrid.com/uk/Electricity/Balancing/consultations/>

If you wish to discuss the content of this letter further or have any queries please contact Ian Pashley on 01926 653446 in the first instance.

Yours sincerely

*[By e-mail]*

Jonathan Munsey  
Regulatory Frameworks Manager

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

We fully agree with the interpretation of uneconomic despatch whereby generators that have other economic options available choose to despatch plant uneconomically to create or exacerbate constraints. This should address the problem of generators profiting from actions in the Balancing Mechanism (BM) as a result of their exacerbation or creation of such transmission constraints. We are supportive of the interpretation in paragraph 2.12 of the consultation which considers that any payments resulting from a bid or offer accepted by the System Operator would be deemed as an excessive amount if the generator had created or exacerbated a constraint. In such cases, we acknowledge that there may be genuine reasons for plant running uneconomically which would become apparent during any exchange of information between the generator and Ofgem.

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

The use of within-day fuel and electricity prices could be a useful benchmark in determining whether a generator has more profitable plant elsewhere on the system; however it could be that some generators may be utilising fuel purchased under longer-term agreements whose prices may deviate from those seen within-day. We note that this approach will take account of different generation types, of which we are supportive as conventional thermal plant will generally have tangible fuel costs as opposed to newer technologies such as wind where there are no fuel costs. This is especially true for renewable generation which will have subsidies such as Renewable Obligations Certificates (ROCs) and Levy Exemption Certificates (LECs) to take into account when calculating profitability.

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

We have not identified other costs in the analysis of despatch decisions.

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

We agree with the examples outlined in paragraphs 2.20 -2.21 which states that coal plant may need to hold back generation to manage their limited running hours due to the Large Combustion Plant Directive (LCPD) or because fuel costs are prohibitive. A further justification is that renewable plant such as wind may seek to despatch their plant when the wind is blowing, thereby exacerbating constraints but it may not be their intention to do so. It will be in their interest to maximise their output due to the nature of the Renewables Obligation and they may have further incentives from contractual arrangements with suppliers to do so. However we note that this will also have an interaction with circumstance 2 where a wind generator may submit high negative priced bids into the BM either in an attempt to gain ‘excessive’ profits or to signal that they do not wish to be curtailed.

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

We have not identified any justifications which should not be considered.

**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?**

Yes. We note, however, that there appear to be two interpretations of the word “excessive” in this licence condition. Under circumstance 1 there is an interpretation that cash flow resulting from any accepted bid or offer would be deemed as an excessive amount if the generator had created or exacerbated a constraint. The interpretation under Circumstance 2 focuses specifically on excessive bid prices which would be derived from comparisons between such costs as comparable generator benchmarks and historical bids.

As discussed above, we consider that excessive fees should be considered in the light of the benefit to the licensee rather than the benefit to the System Operator. On this basis it is easier to deem a benefit which a generator should not have received at all (i.e. because it was exacerbating the impact of a constraint) as excessive.

We note that paragraph 3.1 of the consultation states that Ofgem has a database which contains data on all BMUs in GB and data such as Bid-Offer acceptances, and that this will contain automatic alerts to flag up any excessive prices or despatching of generation when more economic options are available to the generator. However, the consultation does not specify the source of the data for the latest constraint information. Therefore we can only assume that this will be taken from the Balancing Mechanism Reporting System<sup>3</sup> to identify those actions which have been flagged as System actions to resolve constraints.

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

We believe that the consultation has captured the relevant factors for interpreting circumstance 2. However, we note that paragraph 3.1 explains how automatic alerts will be set with “low thresholds” to identify those bids which are excessive compared to the rest of the market. While we understand that Ofgem will have flexibility in assessing such prices, we consider that there will be issues surrounding what precisely constitutes an “excessive price” and we would expect that level to change in line with price movements between settlement periods within the Balancing Mechanism.

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

For plant generally, the existence of transmission constraints may affect their ability to provide balancing services such as frequency response or reserve, and it may be that prices reflect this lost opportunity in some way.

For intermittent generation such as wind plant, they would normally seek to maximise their output due to the nature of their design as there are no fuel costs associated with wind. Paragraph 2.27 provides some justification for this as generators may have a contractual agreement with a supplier to maximise their output. Such agreements are not transparent to the industry as they are negotiated on a bilateral basis and they may impose a penalty on a generator if they reduce their output. Therefore it may be the case that these penalties are priced into their bids amongst other lost opportunity costs. The result would be that such generators price an ‘excessive’ negative bid to signal to the system operator that they do not wish their output to be curtailed rather than to expect their bid to be accepted. In these

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<sup>3</sup> <http://www.bmreports.com/>

circumstances a generator may not be actively seeking to take advantage of their position during export constraints but they will be captured under circumstance 2.

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

We have not identified any justifications which should not be considered.

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

We generally agree that arming fees are the relevant price to capture under this circumstance. However, the focus on arming fees may encourage generators to reallocate high fees elsewhere, for example to “capability fees”, or through increasing use of bundled fees incorporating both arming and tripping. This would enable them to avoid high arming fees by repackaging these charges through other means. While we believe that addressing arming fees in the licence condition is appropriate, further consideration should be given to the contractual structure of inter-trips as there may be commercial arrangements in place to include the aforementioned capability fees.

The interpretation of this licence condition may also incentivise generators to reduce their arming fee but increase their tripping fee by a proportionate amount. Generally we would consider the allocation of risk from an arming fee to the tripping fee is more appropriate as it is in the act of tripping where the cost risk lies. However we would note that the drafting of the condition appears wide enough to cover at least capability and arming fees and that circumstance 2 could be wide enough to cover excessive tripping fees. We note that this licence condition does not expressly cover excessive tripping fees. Whilst it is the case that inter-trip operations are a rare occurrence, excessive tripping fees present an increased cost risk to consumers.

**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?**

We note that the consultation identifies three factors which identify an arming fee as excessive. These are avoidable costs, benchmarks and historical arming fees. Whilst we agree that these should be captured under circumstance 3, further consideration should be given to the approach on how the fees are charged by parties.

For example, the two extremes of inter-trip arming fees are either a value-based approach or a ‘cost plus’ approach. Value-based pricing takes into account the perceived value by a generator of providing the service to the System Operator. This may use the general bid prices as a benchmark to enable a generator to price their arming fee under the market bid prices and can take into account the value of replacing the energy from another part of the system. A ‘cost plus’ approach would take into account the expected costs of arming the inter-trip (which could include for example ongoing maintenance costs and training) plus a marginal profit element. It could be argued that the approach taken to the setting of Arming Fees is a function of the level of competition for service provision in a particular constrained area. These two extremes highlight the difficulties inherent in the use of the word “excessive” in the condition. These difficulties arise from the similarities that will inevitably be

drawn with the notion of “excessive pricing” in competition law<sup>4</sup>. Therefore it might be helpful to deal with this issue by providing some guidance that seeks to distinguish the concept of an “excessive benefit” for the purposes of the condition from the notion of “excessive pricing” under competition law. As discussed above, this is an issue we have raised with DECC and suggested some wording for insertion in the licence condition to address it.

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

In paragraph 2.14, it appears as though any BM Data that is used would primarily be gate closed data, e.g.: FPN data. We note that the majority of our plant scheduling and commitment decisions are based on PN and bid-offer data that is not yet final. We believe pre gate closed data needs to be given due consideration as this data may be resubmitted at any time prior to gate closure.

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<sup>4</sup> Competition law cases can be used to demonstrate that a value-based approach to pricing may not be excessive, even if there is a very significant uplift over the costs of providing the service.