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Dear Ian;

Transmission Constraint Licence Condition Guidance

We set out below RWE's response to the Consultation on the proposed Transmission Constraint Licence Condition guidance. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply & Trading GmbH and RWE Npower Renewables Limited.

We welcome the opportunity to comment on this consultation.

We have included a number of general observations in this response and will include similar comments in our response to the simultaneous consultation being conducted by DECC.

We do not believe that there is a need for the introduction of a Transmission Constraint Licence Condition. The Transmission System is normally operated with a level of constraints which relates to trade off between the economic and efficient investment in electricity transmission assets and the overall cost of temporarily operating with constraints. These transient constraints should not give rise to general concerns about potential abuse of dominant position by certain generators given that the transmission companies can ultimately invest in transmission assets to resolve constraints. In these circumstances, existing competition law should provide sufficient comfort for the regulatory authorities.

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We note that there are certain areas of the GB Transmission System where there may be enhanced level of constraints associated with derogated boundaries that are not compliant with the current GBSQSS. These constraints were created at certain transmission boundaries as a result of the extension of the GB trading arrangements to include Scotland and with the introduction of a connection regime associated with so called "connect and manage" rather than "invest then connect". The constrained transmission boundaries are well known since Ofgem must provide the transmission licensees with derogations for the relevant boundaries with respect to their Transmission Licences. We believe that these boundaries should form the basis of concern with regard to the exercise of market power.

However, we also note that in the investigation of alleged abuse by certain companies associated with the derogated transmission boundaries there was insufficient evidence found to proceed to a referral to the Competition Commission. Furthermore, the costs of any "exploitative

behaviour” in relation to a previous investigation of alleged market abuse was “approximately £125m in 2008/09” according to Ofgem’s Market Power Concerns Initial Policy Proposals (2009). No evidence has been presented that enables market participants to verify this cost and the absence of such evidence calls into question the need for the proposed Licence Condition.

We are concerned that the Licence Condition as currently drafted is too broad and non-specific. There are a range of circumstances that influence the operation of the Transmission System including the specific operating regime of power stations and these could potentially result in constraints being imposed. However, the operators of power stations do not have any visibility of the state of the Transmission System and the existence or non-existence of constraints. We believe that publication of *ex ante* and *ex post* information on the state of the Transmission System will provide power station operators with a better understanding of their dispatch decisions in relation to the potential for constraints. As a start, the System Operator should be obliged to publish information on the state of the Transmission System as they are required under the REMIT obligations.

We believe that Licensees should be able to present evidence to Ofgem to justify the actions taken by them with respect to any alleged Licence breach. It should then be for Ofgem to determine whether a breach has occurred by reference to a set of objective criteria. These criteria should be published at the same time that the proposed Licence Condition comes into force. Furthermore we believe that if the licence condition is introduced the efficiency and effectiveness of its application should be subject to periodic reviews by Ofgem. The outcome of such reviews should be published.

Our comments on the specific questions raised in the consultation document are set out below.

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

We believe that Ofgem should include analysis of the short run and long run costs of power stations in constructing a power station merit order in order to analyse dispatch decisions. This should take into account a power station’s outages, the running restrictions that may prevail in determining availability and the provision of balancing services such as frequency response services to the System Operator. In addition, Ofgem should consider the temporary restrictions including but not limited to the dynamic characteristics of operating (including run up rates, minimum on times, minimum off times and stable export limits).

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

If Ofgem wish to consider generation profitability then factors such as fuel prices and electricity prices must be taken into account. However, a realistic approach towards generation profitability would require an understanding of the short run and long run marginal costs of individual generators in relation to a notional merit order in both constrained and unconstrained locations.

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

In determining whether a generator has created or exacerbated a transmission constraint, Ofgem will need to consider whether the Licensee has operated its power station(s) that are impacted by the constraint in such a way that it influences the decisions taken by the System Operator. This is a more complex problem than simply examining the dispatch decisions of the power station(s) and relates to the options available to the System Operator and the configuration of the Transmission System. We believe that in investigating the potential for a licence breach, Ofgem must examine the decisions taken by both the Licensee and the System Operator in the period preceding the events in question. Finally, Ofgem

should consider the information available to the Licensee with respect to any constraints in the events leading up to its dispatch decisions.

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

We do not believe that power station operators would dispatch their power stations “uneconomically”. However, there may be circumstances where it may be economic and efficient for power stations to operate during period of low power prices in order to maintain availability for despatch during periods of higher power prices. For example, power stations may wish to ensure that they are operating at stable export limits overnight in order to be available from warm for the morning pick up of demand. The overnight running of such power stations should not be regarded as “uneconomic dispatch” and should be taken into account in considering a plant’s operating characteristics.

We would expect that certain inflexible power stations such as nuclear plant would continue to operate during periods of low power prices in the presence of transmission constraints since the costs of shutting down would outweigh the benefits. In these circumstances we would expect wind farms to be curtailed in the constraint affected area ahead of nuclear power stations.

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

We are concerned that under Circumstance 1 the burden of proof will rest with the licensee after Ofgem has determined that it may have operated “uneconomically”. We do not believe that this is appropriate and it could give rise to numerous and costly investigations. Ofgem should publish objective criteria as to what may constitute “uneconomic” behaviour. In any investigation it should be for Ofgem to present evidence that identifies the nature of the possible Licence breach.

In the context of Circumstance 1 of the proposed Licence Condition, the objective criteria for assessment of the potential for a breach of Licence should include, *inter alia*, the following:

- A transmission constraint was in existence and the System Operator had provided prior notification to the relevant Licensee of the transmission constraint with respect to the relevant power station or power stations; and
- An event or series of events had taken place at the relevant power station (owned or operated by the Licensee) either in the form of a change of operating regime or published characteristics following notification of the transmission constraint; and
- The event or series of events at the power station had a material impact on the costs incurred by the System Operator associated with resolving the transmission constraint; and
- There was published evidence from the System Operator that the actions of the Licensee had created or exacerbated the constraint including evidence in relation to the options available to the System Operator to resolve the constraint in different timescales prior to the existence of the constraints and during the constraint event; and
- There was a material gain for the Licensee in relation to the power station as a direct result of the change that occurred at the power station with respect to actions taken by the System Operator

In all cases the materiality of the costs should be defined with respect to a financial impact. The starting point for materiality should be costs incurred by the System Operator for resolving the constraint.

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 do not believe that the indicators outlined in the consultation document are useful for Ofgem in considering whether the bids are excessive or not. In particular the indicators as described are subjective and open to an element of judgement. The indicators do not reflect the actual circumstances in which Licensees may operate power stations and price bids. We believe that Licensees should be allowed to present a case to Ofgem once evidence of a potential breach of the Licence Condition in relation to objective criteria has been notified by Ofgem to the Licensee. Ofgem's evidence could, of course, make reference to avoidable costs and comparable generator benchmarks.

We are concerned that the use of the indicators as described in the consultation document could give rise to unwarranted investigations of alleged uneconomic behaviour with respect to transmission constraints. In particular there may be a range of operating regimes available to a generator that are derived from a combination of circumstances whereby comparison with "avoidable costs" or "comparable generator benchmarks" could *prima facie* appear "excessive" according to the various indicators.

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

Ofgem should present evidence of a potential Licence breach in relation to objective criteria with respect to this circumstance and it should then be for the Licensee to present evidence that indicates that its behaviour in relation to bid or offer pricing was justified. This could include a range of indicators and information which could be made available by Licensees on a confidential basis.

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

We do not believe that power station operators should have to provide justification of "seemingly high bids" with respect to actions that may or may not be taken by the System Operator. Only once Ofgem has provided evidence that a potential breach of the Licence condition has occurred in relation to objective criteria should the Licensee be required to submit evidence. In these circumstances it would be for the Licensee to provide the relevant arguments and objective justification of its pricing strategy. This could include the submission of market sensitive and confidential information that may assist Ofgem in making a determination.

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

We are concerned that under Circumstance 2 the burden of proof will rest with the Licensee after Ofgem has determined that it may have provided "excessively" priced bids or offers. We do not believe that this is appropriate and could give rise to numerous and costly investigations. We believe that Ofgem should publish objective criteria as to what may constitute "excessive" pricing behaviour. In any investigation it should be for Ofgem to present evidence that identifies the nature of the possible Licence breach.

In the context of Circumstance 2 we believe that Ofgem should publish a set of objective criteria that defines potentially excessive pricing behaviour. These should include, *inter alia*, the following:

- A transmission constraint was in existence provided that the System Operator had notified the relevant Licensee of the transmission constraint with respect to its relevant power station or power stations; and

- The System Operator accepted a bid or offer in relation to a relevant power station owned or operated by the Licensee; and
- The bid or offer acceptance had a material impact on the costs associated with resolving the transmission constraint; and
- The potential for market power existed in relation to a relevant power station, where market power is defined with respect to the concentration of options available to the System Operator to resolve the constraint where such options include changes to output at licensed generation, unlicensed generation and from demand side response.

In all cases the materiality of the costs should be defined with respect to a financial impact. The starting point for materiality should be costs incurred by the System Operator for resolving the constraint.

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

We do not agree that the relevant price is the arming fee in relation to commercial intertrips under Circumstance 3. We are concerned that Ofgem is considering taking action in relation to “excessive” arming fees without defining the alleged market abuse that could occur. We believe that a set of objective criteria are required for assessing whether a potential breach of the Licence has occurred with respect to the licensee under Circumstance 3.

We do not believe therefore that a Licensee can be found to be in breach of its Licence irrespective of whether a transmission constraint occurs. The existence of a commercial intertrip contract which is entered into by the System Operator and a Licensee before a relevant transmission constraint occurs should not be considered as a potential breach of its Licence.

Licensees have limited visibility on the potential for constraints or system faults that give rise to the need for an intertrip scheme. In addition, Licensees with intertrips do not know the scale or magnitude of the actual capacity restrictions on the Transmission System. It is for the System Operator to determine whether to arm an intertrip, undertake other pre-fault actions or allow the potential for a transmission constraint to occur.

Furthermore, we note that the arming of an intertrip may actually prevent a constraint occurring by ensuring that a power station is interrupted ahead of other users of the Transmission System. Consequently, from the perspective of the Licensee if an intertrip is armed then from it would appear that the System Operator has determined that the arming of the intertrip scheme is more economic and efficient than other options that are available.

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?

Ofgem should present evidence of a potential Licence breach in relation to objective criteria and it should be for the Licensee to present evidence that indicates that its behaviour in relation to bid or offer pricing was justified. This could include a range of indicators and information that could be made available by Licensees on a confidential basis. We believe that any indicators used should be published ex ante by the System Operator and remain visible to Licensees.

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

We are concerned that under Circumstance 3 the burden of proof will rest with the Licensee after Ofgem has determined that it may have been paid an “excessive” amount in connection with the Licensee preparing for the possible cessation of generation. We do not believe that this is appropriate and could give rise to numerous and costly investigations. We consider that Ofgem should publish objective criteria as to what may constitute “excessive” amounts under this circumstance. In any subsequent investigation it should be for Ofgem to present evidence that identifies the nature of the possible Licence breach.

In the context of Circumstance 3 we believe that Ofgem should publish a set of objective criteria that defines the potential for the Licensee to be paid an “excessive amount” to prepare for the possible cessation of generation. These should include, *inter alia*, the following:

- The System Operator had notified the relevant Licensee that there was the potential for a transmission constraint to exist in relation to the relevant power station; and
- An event or series of events had taken place at a power station owned and operated by the Licensee either in the form of a change of operating regime or published characteristics following notification of the potential for a transmission constraint; and
- The events at the power station had a material impact on the costs incurred to resolve the potential transmission constraint by the System Operator; and
- The System Operator has presented evidence that it either armed an intertrip scheme in relation to a power station owned or operated by the licensee or considered arming such an intertrip scheme; and
- The potential for market power existed in relation to the relevant power station, where market power is defined with respect to the concentration of options available to the System Operator to resolve the constraint where such options include changes to output at licensed generation, unlicensed generation and from demand side response.

In all cases, the materiality of the costs should be defined with respect to a financial effect. The starting point for materiality should be costs incurred by the System Operator for resolving the constraint.

We believe that Circumstance 3 can only apply in situations where there are no other options available to the System Operator other than actions undertaken specifically at the power station owned or operated by the Licensee. In these circumstances the arming fee should be compared with the other options at the power station (including bid prices) in determining whether there is the potential for the exercise of market power. Consequently, in considering any potential Licence breach Ofgem should consider all relevant information including the options available to the System Operator.

Yours sincerely,



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