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Dear Sir/Madam,

RenewableUK consultation response
TRANSMISSION CONSTRAINT LICENCE CONDITION AND GUIDANCE

RenewableUK and Scottish Renewables collectively represent the major sectors and technologies within the UK's renewable energy industry. Our members include supply chain companies both manufacturing and services; renewables developers & generators; and conventional energy companies with renewables portfolios. Some members may make their own responses to consultations where they have specific expertise, perspectives or interests that are wider than the wind, wave and tidal sector. It follows that not all members necessarily agree with or support the associations' joint response. The associations' response aims to represent wind, wave and tidal industries, aided by the expertise and knowledge of our members.

Introduction

RenewableUK and Scottish Renewables welcome the opportunity to input into Government's consultation on the introduction of a Transmission Constraint Licence Condition, and Ofgem's

consultation on the guidance for this. We are aware of concerns that bid and offer prices could be used to make excessive profits at times of transmission constraint. However, our response revolves around the following points:

- **We believe it is premature to introduce a Licence Condition such as that proposed.**
- **The Licence Condition could have a number of detrimental, unintended consequences.**
- **If the Licence Condition is introduced, we would like to see safeguards to minimise the negative impact.**

Rather than completing separate response forms to DECC and Ofgem, we have chosen to set out the issues and comments in this letter.

The Need

We would like to review the original purpose of the Transmission Constraint Licence Condition. – Ofgem made the decision to propose this Condition following a Competition Act investigation in 2009, before wind generation was being constrained. Whilst wind constraints have since arisen, addressing these was not the purpose of the Licence Condition. Additional care is therefore needed in identifying the objective of the Condition in relation to wind, and the potential unintended impacts on the wind industry.

There has been concern since autumn 2011 about some of the bid prices submitted by wind generators into the Balancing Mechanism. There are a number of reasons why some bid prices have been elevated. Overall, wind generation has not traditionally sought to participate in the Balancing Mechanism, and bid prices have historically been set at a level intended to ensure that wind was not called off. – Unlike other forms of generation, wind does not benefit from reduced fuel costs as a result of being constrained off.

Since autumn 2011, it has become clear that wind generators will increasingly be called upon to curtail their output, primarily on account of the need for investment in transmission infrastructure in many areas of high renewable resource. Accordingly, the wind industry has been working together with National Grid as System Operator, to improve participation in the Balancing Mechanism. Activities have included:

- installation of the necessary electronic kit to allow rapid information exchange
- regular progress meetings between National Grid and industry representatives
- encouragement of the industry to review their bid prices to ensure cost-reflectivity
- visits to National Grid and wind operator control rooms to understand the practicalities

Further activities are planned, including a review of contractual requirements that may currently act as a barrier to fuller participation.

Effective industry solutions are favourable to Government or regulatory intervention, and evidence suggests that wind generator bid prices are indeed being reformulated in the light of greater knowledge and experience from the five months of industry activity described as above. However, it does take time to review and amend the contracts and finance models for these long-term investments, and then further time to assess the impact of these reviews when payments are being reconciled. This work is by far from finished. We therefore believe that the introduction of a Licence Condition is premature.

Furthermore, whilst there has been criticism of the wind industry that bid prices had been set at elevated levels, for reasons given above, there has been no suggestion to date that bid prices were being varied to coincide with periods of constraint, in an active attempt at market manipulation. It would be helpful to see any evidence that suggests otherwise.

Concerns

Whilst the proposed Licence Condition could be assumed to have only benefits (“why is it a problem if nobody is doing anything wrong?”), on closer consideration it has a number of negative consequences. These are set out below:

First, the prospect of an investigation, with potential sanctions, in relation to complex business activities that are evolving with time, would represent a material risk to the financeability of generation projects. The Licence Condition is associated with a very large sanction (10% of company turnover). At a time when it is already difficult to raise finance for renewables projects, this additional level of risk, that cannot be easily controlled, exacerbates the problem.

Second, as a result of the above, the industry would inevitably adopt highly risk-averse behaviour, including: more resource into decision making regarding the generation profile; and more resource into auditing and recording these decisions. Not all companies would invest in these at the moment, because some companies may choose to have bilateral contracts rather than participate in the Balancing Mechanism. The additional requirements would therefore translate into higher costs, costs ultimately passed on to consumers. This should be reflected fully in the Impact Assessment.

Third, at a time when the wind industry has been encouraged to engage more actively with the Balancing Mechanism, the proposed Licence Condition is a disincentive. With its onerous requirements and threat of sanctions if Ofgem deems bid prices to be “excessive,” it

encourages the industry not to participate actively and effectively to opt out of the Balancing Mechanism.

Finally, although there is the prospect of all bid strategies being monitored, we note that, in the first instance, the proposal is to review bids and offers that are accepted. While this may be a practical approach, it delivers a situation where generators who are called off because their bid prices are favourable are as a result placed on the priority list for review. This could deliver the exact opposite of what industry is trying to achieve with regard to Balancing Mechanism behaviour.

Necessary Conditions

If the Government is committed to introducing the Licence Condition, there are three conditions that need to be met.

First, there needs to be clarity on what is meant by a relevant constraint. – Transmission constraints occur frequently throughout the grid. There is a need to define which constraints might be considered to be relevant to which generators. There may also be an interplay of other reasons given for constraints, for instance, the need to preserve voltage stability by favouring thermal plant. Without complete clarity on what is considered relevant, generators will be operating in the dark as to the monitoring of their decisions and knowing when they may be considered to be at fault.

Second, there needs to be clarity on the definition of excessive benefit. – Wind generation bid prices reflect more than just the energy and ROCs foregone. There are also equipment amortisation issues, operational overheads, wear and tear and warranty related issues, motivation for being in the generation business, compensation arrangements under PPAs, etc., that may affect a generator's desire to participate in the Balancing Mechanism, and therefore their bid price. Costs incurred over a significant amount of time may be recoverable through bid prices over a very short timeframe of constraints.

Third, there is a need for an appropriate process for investigating concerns. – It is not appropriate to raise concerns in a way that is public, or can be publicly identified (for instance, under Freedom of Information requests), when the party has not necessarily done anything wrong. And, in view of the complexity of transmission constraints and bid pricing, it is appropriate to ensure that parties are given early warning if it looks like their behaviour could lead to them being in breach, in order that they can review their behaviour themselves and take action accordingly.

Finally, in view of the concerns about potential negative consequences, and in view of the proposed Transmission Constraint Licence Condition not being a fundamental part of market operation, we recommend a shorter period “sunset clause” on the Condition. The period would need to be sufficiently long to allow practices to bed down and for DECC and Ofgem to ascertain whether the practices they would like to see have been put in place, but certainly not as long as the five year period proposed. Thereafter it should be a matter of demonstrating with evidence the need for the Secretary of State to extend the Condition by a further year.

In summary, RenewableUK and Scottish Renewables are concerned about the need; the consequences; and the practicability of the proposed Licence Condition. We would be happy to discuss these issues in more detail with you.

Yours sincerely,

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