

## **Response to Ofgem consultation on Update to the Transmission Constraint Licence Condition guidance**

1 February 2024

### **About EPUKI**

EP UK Investments (EPUKI) is a UK energy company, primarily focusing on power generation from conventional and renewable sources.

EPUKI is the UK division of Energetický a průmyslový holding (EPH), a leading energy group of over 70 companies that owns and operates assets across Europe. EPH group employs circa 25,000 people internationally, owns €16.7bn of assets, generating €8.6bn of revenue and an EBITDA of €2.1bn.

Since it was established in 2015, EPUKI has expanded to be one of the largest independent generators in the UK and Ireland and owns and operates multiple renewable and flexible power generating assets in those markets. These include Lynemouth Power, a market leading 400 MW renewable biomass plant, and 3.3 GW of gas-fired plants which provide flexible generation and services: South Humber Bank, Langage, Ballylumford and Tynagh Energy.

EPUKI is investing in new flexible generation capacity in both the UK and Ireland. In February 2023 EPUKI secured 15 year capacity agreements for a combined 1,700 MW high efficiency H-class CCGT power project and a 299 MW 2 hour battery storage project at the site of the former Eggborough coal station in East Yorkshire. This would represent an investment of circa £1.5 billion in the UK's electricity supply. The high efficiency H-class CCGT project will be the single largest flexible generation asset to be commissioned in the UK since 2012, whilst the battery project will also be one of the largest to be built in the UK to date.

### **General comments**

EPUKI welcomes the opportunity to comment on the proposed updated TCLC guidance. We agree that the guidance requires review as Ofgem's approach to TCLC has shifted from that which was widely understood in the electricity market when TCLC was originally implemented. TCLC contains concepts which are unique to this licence condition, which Ofgem has indicated will not be interpreted by reference to existing and well-known legislation and regulation. The guidance is therefore a crucial aspect of the application of TCLC especially as, as stated in the licence condition itself, the 'licence condition shall be interpreted and enforced in accordance with guidance published by the Authority'.

The guidance document must therefore be robust and contain as much detail as possible about Ofgem's interpretation of the TCLC, acting as a practical guide to help licensees understand how to remain compliant with the licence condition. We are disappointed that Ofgem has not reviewed the TCLC guidance in seven years. Given the importance of the guidance to understanding the licence condition, it should be a living document that is constantly reviewed and refreshed in light of experience. If the guidance is not regularly maintained, licensees have to form their own view on key issues of interpretation that may be at odds with the views of the regulator, opening licensees up to compliance risk.

The ongoing requirement for TCLC demonstrates the lack of investment in electricity networks undertaken over the past decade. Ofgem appears to be addressing these failures in network investment through an increasingly broad interpretation of TCLC. The extension of TCLC to a wider range of operational considerations, such as RoCoF management, will make compliance with TCLC much more difficult for licensees because they do not know exactly what Ofgem will class as a transmission constraint and when the relevant system conditions which cause it might arise.

We do not support Ofgem's view that it is not necessary for a licensee to know in advance when a transmission constraint is in force for TCLC to apply. In general, if a licensee cannot be aware in advance that a transmission constraint exists then they would always have to price their bids on the assumption that a transmission constraint did exist in order to ensure compliance with the requirements of TCLC. This effectively makes TCLC a blanket regulation of bid prices on a 'cost plus reasonable profit' basis. This approach is entirely at odds with the original intention of TCLC, which was to target pricing only where a generator was subject to a transmission constraint, and is at odds with the established concept of competitive pricing in GB energy markets.

As a principle of good regulation, we consider that licensees should know when they are at risk of breaching a relevant requirement. We therefore consider that there should be an obligation on the System Operator to notify a generator when it is affected by a transmission constraint. In general, we would support much greater transparency around the nature and location of transmission constraints as this would allow parties to make informed investment decisions, including where to locate plant so as to help resolve transmission constraints.

Ofgem's proposed approach to assessing 'reasonable profit' under TCLC also opens up licensees to compliance risk as there is considerable uncertainty in the guidance as to what Ofgem may consider reasonable. Ofgem's determination of what is a reasonable profit appears to be based on a counterfactual (the level of profit that would have been realised from bids had a transmission constraint not been in force) that it is impossible for a generator to predict. At one point, Ofgem even suggests that most bids which are subject to TCLC should be priced on a 'cost only' basis without any profit margin. Such a proposal would result in generators regularly located behind a transmission constraint being at a commercial disadvantage with generators who are not and are free to price a larger profit margin into their bids. Given the uncertainty over what level of profit counts as reasonable, licensees would have to take a very conservative approach to pricing in all circumstances in order to ensure that bids captured by TCLC were within Ofgem's view of reasonableness.

When coupled with the uncertainty as to when a transmission constraint exists and TCLC will apply, this approach to pricing means that bids in all Settlement Periods may have to be priced on an extremely conservative basis. The implications of this are that profit from bids, including those accepted for energy purposes, submitted by all generators will be severely limited. This is likely to act as a significant deterrent to investment in flexible generation in Great Britain or lead generators to recover any lost income from other sources, resulting in higher prices in other markets such as the Capacity Market or ancillary service markets. Furthermore, TCLC could end up limiting the ability of generators to capture value where they have already invested in new or additional capability specifically to provide downward flexibility that helps manage system operation issues.

EPUKI considers that the broad, untargeted nature of TCLC and the challenges it presents to licensees in ensuring compliance creates an extremely high regulatory burden for market participants. The vague nature of the guidance means that there is a low bar for Ofgem to launch an investigation under TCLC and significant scope for Ofgem to reach a different interpretation to a licensee as to whether submitted bids are compliant with the licence condition. An extremely burdensome and risky regulatory environment, such as that which Ofgem has created through TCLC, is likely to be a disincentive to investment in the GB electricity market at a time when additional investment is required to help address system operation issues.

We are concerned that TCLC has strayed a long way from the targeted and time-limited intervention that was approved by Parliament in 2010 and that it has become a tool for the blanket regulation of bid prices in the Balancing Mechanism, contrary to the established principles of the competitive electricity market in Great Britain. Ofgem should seriously consider whether TCLC would actually be enforceable under its proposed approach, as the vague nature of the TCLC and the difficulties that it and the accompanying guidance present to generators in ensuring compliance are likely to be strong grounds for challenge during any enforcement action. In general, EPUKI therefore considers that TCLC no longer serves a useful purpose and should be abandoned. If Ofgem wishes to continue with its apparent aim of regulating all Balancing Mechanism pricing, which is contrary to the principles established under UK energy legislation, it should seek consent for this approach from government and Parliament via new legislation.

## Response to specific questions

### Q1. Are there additional areas of background that respondents would find it useful to have covered in the guidance?

We do not consider that there are additional areas of background that need to be covered.

### Q2. Are there areas where respondents consider that the guidance would benefit from additional detail on Ofgem's interpretation of or approach to the enforcement of the TCLC?

Please see the table of detailed comments below. In general, we consider that the guidance is too vague in relation to the key points of the definition of a transmission constraint and the assessment of reasonable profit. This lack of clarity increases compliance risk for generators.

### Q3. Are there any areas where respondents consider that the proposed changes to the guidance are unclear?

Please see the table of detailed comments below.

### Q4. Are there any examples of material costs or benefits of curtailment that are missing from Table 1?

We have not identified any specific examples at this stage.

### Q5. Are there circumstances which could objectively justify bid prices that would otherwise be excessive, which are not captured in the updated guidance?

Please see the table of detailed comments below.

### Q6. Do respondents have any other comments on the proposed changes to the TCLC guidance?

Please see the table of detailed comments below.

## Table of detailed comments

| Para  | Ofgem text   | EPUKI comments   |
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| Fig 1 | 1. Is there a transmission constraint affecting the generation unit?                         | <p>As explained in our comments below, the lack of available information on the existence of transmission constraints and the expanded nature of the TCLC means that generators are unable to know with any certainty whether there is a transmission constraint which affects them and therefore whether the first step in Ofgem's assessment of a potential TCLC breach applies. We consider that knowledge of the existence of a transmission constraint should be a prerequisite for Ofgem to pursue enforcement action under TCLC. We therefore suggest that this initial step in Ofgem's assessment should read 'Is there a transmission constraint affecting the generation unit of which the licensee is aware?'.</p> <p>We consider that Ofgem should oblige the ESO to notify a generation unit when it is subject to a transmission constraint. Whether or not such a notification has been issued should be an additional factor in Ofgem's assessment of potential breach of the TCLC and incorporated into Figure 1.</p> |
| 2.9   | Therefore, the constraints that Ofgem will focus on when assessing potential breaches of the | By including economic considerations rather than purely technical considerations in its assessment of constraints covered by TCLC, Ofgem appears to be   |

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|      | TCLC are those which can only be practicably and/or economically resolved by the ESO by instructing either a single generator or a particular group of generators connected to a specific part of the network to reduce their output. | expanding TCLC potentially to include all system management actions taken by the ESO. This makes TCLC so broad that it would be impossible for a generator to comply with as a generator could not know whether the alternative system management options available to the ESO were more expensive than its bids and therefore whether a transmission constraint is in force.  |
| 2.14 | This change dealt with the possibility that as the system evolved, other types of transmission constraints beyond those relating to thermal, voltage and stability limits could arise – and thereby to future proof the obligation.   | Ofgem's interpretation of this change has expanded the scope of TCLC to capture a wider range of system management issues that may not obviously be locational and of which market participants may not be aware. This means that the only way in which market participants could be sure that they are compliant with TCLC would be to assume that all bids are subject to the licence condition. This damages the competitive energy bid market and goes beyond the original intent of TCLC, making the TCLC a blanket restriction on bid pricing. We therefore consider that Ofgem should publish a definitive list of all balancing actions which are covered by TCLC. This list could be periodically updated to ensure it remains up to date.  |
| 2.17 | the clearest available indicator is the licensee's ability to retrospectively observe whether or not bids are system flagged  | The reliance on system flagging to understand the existence of a transmission constraint means that generators can only know retrospectively that their bids might have been subject to TCLC as bids are flagged following acceptance. Generators would therefore not know about the existence of a transmission constraint at the point at which they submit their bid prices. Given that standard industry practice is not to amend bid and offer prices once acceptances begin to be flagged by the ESO, generators should be informed in advance of their bid submission whether a constraint is or is likely to be in force. In the absence of such knowledge, the only way to be compliant with TCLC would be to price all bids in the expectation that they may be subject to TCLC, which would make TCLC a blanket restriction on bid pricing. |
| 2.18 | a generator can reasonably expect that where it has bids accepted which are subsequently system flagged, those bids will have been accepted in relation to a transmission constraint as defined in the TCLC                           | Ofgem is stating that all actions which are system flagged are transmission constraints under TCLC. We note that actions related to RoCoF management are system flagged under the System Management Action Flagging Methodology Statement and that Ofgem believes that these are captured under TCLC. These actions are related to the management of an issue which arises from a factor (inertia) which is system wide and non-locational. This is a significant change in the nature of TCLC. Ofgem's stated equivalence of system flagging with a transmission constraint under TCLC therefore significantly increases the scope of TCLC and makes compliance much more challenging for generators as the range of bids captured will increase.   |

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|      |   | <p>Ofgem's approach also attaches additional significance to system flagging which was not intended when flagging was originally introduced. System flagging under P217 was intended as a mechanism to identify actions to remove from the cashout calculation, not as a signal to generators about how to price their bids. We consider that a complete review of system flagging, including definitions under the BSC and transmission and generation licences, would be required if Ofgem expects system flagging to be used for this different purpose.</p> <p>We note that there may be circumstances where system flagging itself does not provide a clear signal to generators. For example, some bids can be subject to "dual flagging", which occurs where some of the bid volume during a settlement period is accepted for energy purposes (and is therefore unflagged and not subject to the TCLC) and some is accepted for system management purposes (and is therefore flagged). In these circumstances a generator would assume that its pricing was reasonable because the bids were being accepted for energy purposes, but Ofgem may consider them to be covered by TCLC and therefore apply a test of 'excessive benefit'.</p> |
| 2.18 | Note that the converse may not always be true – ie it is possible that on occasion bids which are not system flagged may nevertheless relate to a transmission constraint as defined in the TCLC.   | This means that there may be some transmission constraints for which there is no indication to a generator that such a constraint exists and that the generator's bids in the period in which the constraint existed were subject to TCLC. We consider this situation to be unacceptable. It should not be the case that a generator can be subject to enforcement action in respect of a constraint that is effectively invisible to the market.   |
| 2.19 | In addition to system flagging, further information on the presence and nature of constraints and the rationale behind individual dispatch decisions is also available to market participants via the ESO's publications. While the information published by the ESO changes over time, at the time of this guidance being published this includes information published to the ESO data portal, as part of the Electricity Ten Year Statement, and within its regular operational transparency forums. | We do not consider it reasonable for Ofgem to expect a licensee to familiarise itself with all aspects of system operation in order to understand whether it may be at risk of breaching the TCLC. System operation issues are complex and specialist in nature and it is not possible for all generators to be expert in them. There should also not be an obligation on generators to read every industry publication and attend every industry forum to understand the application of TCLC, especially as the information released through these channels is often retrospective in nature and may not be published by the ESO for a long time after the original operational issue arose. An obligation on the ESO to inform affected generators of the existence of a transmission constraint would therefore make TCLC compliance much easier for a generator.  |
| 2.20 | There is no requirement under the TCLC that a generator must know that a constraint exists in order for the obligation that it should not   | As a principle of good regulation, we consider that regulated parties should know when they are at risk of breaching relevant regulations. We consider Ofgem's position that a generator does not need to know that a transmission constraint exists to be  |

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|      | obtain or seek to obtain an excessive benefit to apply.   | unworkable. If constraints exist of which a generator may not be aware, the only way a generator could ensure that it does not obtain an excessive benefit if such a constraint did exist would be to price all its bids on a 'cost plus reasonable profit' basis, even those which are eventually accepted for energy purposes and therefore should not be subject to TCLC. For reasons of fairness and to ensure that the TCLC is appropriately targeted, we therefore consider that there should be an obligation on the ESO to inform a generator when it is in a location which is subject to a transmission constraint.   |
| 2.26 | in order to assess whether a price was excessive we will generally consider whether that price was set at a level which meant that the benefit that the licensee either obtained or sought to obtain in relation to Transmission Constraint Periods was significantly greater than the benefit it would have obtained in the absence of any transmission constraint | <p>By focusing on whether or not a licensee subject to a transmission constraint received a 'significantly greater' benefit than that which it would have received absent the transmission constraint, Ofgem appears to be focusing upon the total profit received from an accepted bid or series of bids, rather than the profit margin (in £/MWh).</p> <p>It would be practically impossible for a generator to make an ex-ante estimate of the benefit it may receive from a bid or series of bids absent a transmission constraint, since it cannot know with any certainty the volume of bid acceptances it may reasonably expect to receive (either in the presence of the transmission constraint or in the imagined counter-factual where said constraint does not exist). It would therefore be impossible for the generator proactively to price any bids subject to a transmission constraint at such a level that it did not receive a total benefit which was greater than it would have received absent the constraint.</p> <p>Even ex-post, a generator would be unlikely to be able to estimate the volume of bid acceptances it may have received if a transmission constraint did not exist. Such an estimate would require generators to undertake detailed bid market modelling which should not be a requirement to operate in the market.</p> |
| 2.31 | Because the cost and benefits of being bid down determine the level of benefit obtained, where a licensee does not have regard to these costs and benefits when setting its bid prices in transmission constraint periods, it carries an intrinsic risk of breaching the TCLC.  | The Balancing Mechanism is designed as a competitive pay-as-bid market which incentivises generators to offer its services at what it expects to be the marginal accepted price. TCLC requires generators to adopt a different approach, whereby bid pricing is determined primarily by reference to the costs and benefits of being bid down. Given the fundamental difference in these two approaches, it is crucial that a generator is clear when a transmission constraint period is in force and therefore when it needs to adopt a more restrictive approach to its pricing. Without this clarity, generators would have to assume that they must always bid on a 'cost plus reasonable profit' basis as if a transmission constraint period did arise they would need to demonstrate to Ofgem that they had had regard to the costs and benefits of being bid down.   |

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|      |  | Forcing generators to bid on this basis would act as a significant disincentive to investing in increased flexibility and efficiency. The normal driver for such investments would be an expectation that they would reduce the overall costs of generation and thus increase profits when bidding at a price in line with the marginal units in the market. The proposal that bid pricing should instead be determined by 'costs plus a reasonable profit', would make such investments entirely pointless.   |
| 2.35 | When licensees are estimating their costs for the purposes of setting their bid prices in transmission constraint periods, we therefore expect them to take into account a reasonable expectation of the extent to which they are likely to be bid down for single or multiple consecutive settlement periods, to avoid over-recovering.   | This suggestion is entirely unworkable. It is impossible for a generator to estimate how long they may be bid down for as this is outside of their control, especially in cases where the existence or cause of a transmission constraint is unknown to them. It is unclear what Ofgem's definition of a 'reasonable expectation' might be in these circumstances and there is therefore a risk that the generator may form a different view of what is reasonable from the regulator, leading to increased compliance risk. Ofgem must recognise that it cannot enforce exact recovery of costs in these circumstances. |
| 2.37 | One factor we may have regard to when assessing a breach of the TCLC is any evidence on the efficiency of the costs being recovered via bid prices. Where reported curtailment costs appear particularly high compared to those of comparable generators, then including those costs in bid prices in transmission constraint periods may result in an excessive benefit being obtained. The same applies to costs which do not appear necessary to achieve curtailment. This follows from the broader principle that market power can result in excessive profits – but also cost inefficiency due to the lack of pricing pressure faced by the company enjoying a lack of competition. | We are unclear exactly what Ofgem intends generators to do in response to this paragraph. A generator cannot know what the costs faced by its competitors are and how its competitors' bid prices are derived as this is commercially confidential information. A generator can therefore only benchmark the overall bid price against its competitors, which would be normal market practice in a competitive market. We therefore request additional clarity on the significance of this element of the guidance.  |
| 2.38 | we consider that it would not be reasonable for a generator to recover a profit margin in £/MWh via their bid prices which would allow them to obtain an overall profit in pounds that is significantly greater than that which would be expected absent the transmission constraint.  | It is not possible for a generator accurately to estimate the volume of bid activity it might receive (either with or without a transmission constraint) and therefore its profit received from bids as this is entirely in the control of the ESO. This approach would require generators to undertake detailed bid market modelling which should not be a requirement to operate in the market.  |
| 2.39 | Given this, there is no single 'maximum' level of profit in £s, £/MWh or percentage terms that generators are allowed to include in their bid prices in transmission   | A generator cannot control the profit they earn on bids in a settlement period (whether or not a transmission constraint is in force) as it is not in control of the bid volume that is accepted by the ESO. A generator would, in the absence of a  |

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|      | <p>constraint periods. Instead, what is reasonable will depend on the circumstances – and it is contingent on licensees to ensure that any profit or contribution to indirect costs priced into their bids does not result in them obtaining a benefit that significantly exceeds that which they would have expected to earn on bids in those same settlement periods in the absence of any transmission constraint.</p>   | <p>transmission constraint, be incentivised to price its plant to maximise bid profit by pricing at the marginal bid price. By pricing at this level, the generator's expectation is that it might have bids accepted on some or all of its volume and earn a profit. As the generator's expectation is that it may receive bid activity absent a transmission constraint and generate a profit, we are unclear whether Ofgem is proposing that generators should alter their pricing strategy if they believe that a transmission constraint may be in force and how this is consistent with the approach detailed in paragraph 2.40.</p>   |
| 2.40 | <p>In most cases, we would expect generators to be bid down significantly less frequently absent a transmission constraint – and to face more competition. Therefore any contribution to profits or indirect costs that it is reasonable for licensees to factor into bid prices in transmission constraint periods under the TCLC may often be quite limited – particularly where the economics of the unit involved are such that it would not commonly be bid down absent the constraint.</p>  | <p>Ofgem appears to be suggesting that, in most cases, bids covered by the TCLC would not have been accepted if a transmission constraint was not in force and therefore no profit should be able to be recovered through bids covered by the TCLC. Given that generators cannot know in advance when their bids might be captured by TCLC or would be accepted for energy reasons, this suggests that generators should in general be pricing their bids on a cost-only basis to ensure they are compliant with TCLC. This position is clearly unacceptable and would disincentivise investment in the energy market in Great Britain. Flexible generation which provides system services will be essential to managing the electricity system in future. The position that Ofgem is adopting, namely that such generators should offer their services to the System Operator on a cost-only basis, will either stop all investment or lead to higher costs in other mechanisms, such as the Capacity Market or ancillary services, as generators seek to recover a profit there.</p> <p>We are unclear what is meant by the reference to the 'economics' of a unit in this paragraph. It is not a function of the economics of a unit whether it would commonly be bid down, but rather a function of the balance of the electricity system.</p> |
| 2.43 | <p>When carrying out a comparison of bid prices across generation units, typically we will only consider comparisons with generators of the same technology type. This is because different generation technologies are likely to incur significantly different costs – both in terms of the direct costs of being bid down, and the indirect costs associated with operating in the BM. It may not be appropriate to compare generators even of the same technology type if they are operating in different ways or subject to different operating conditions.</p> | <p>Ofgem appears to be using a highly selective approach as to which generators are comparable. As licensees cannot predict Ofgem's selection criteria, they cannot meaningfully benchmark their own prices against those of their competitors to understand what is reasonable. This creates significant compliance risk as the licensee would either have to second guess the regulator's approach or adopt an extremely conservative approach to its own pricing strategy to guarantee compliance. Ofgem should clarify the exact circumstances in which generators will be considered comparable.</p>  |
| 2.44 | <p>When carrying out our analysis, we will generally avoid comparisons</p>  | <p>As under paragraph 2.43, Ofgem's intention to focus on the average prices of an unknown subset of</p>   |



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|  | <p>with any single generator or to focus on any single settlement period. This is because it can be difficult to fully observe the conditions under which bids are being submitted by different generators, and so to form a view on their suitability as comparators. Instead, we will typically focus on differences in average prices over sustained periods of time, reducing the sensitivity of our analysis to outliers.</p> | <p>generators makes it impossible for a licensee to benchmark its own pricing strategy against its competitors.</p> |
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