

Ofgem's Transmission Constraint Licence Condition guidance consultation
and
Call for Input Transmission Constraint Licence Condition
Response from ENGIE

Background to ENGIE

- ENGIE is a global energy player, focused on renewable energy and low carbon distributed energy infrastructures.
- In the GB market, ENGIE owns First Hydro in a 75/25 J/V with Brookfield Renewables Partners. First Hydro comprises two pumped storage stations with a total generation capacity of 2.1GW and a combined storage capacity of 12GWh.
- ENGIE is also developing two 50MW battery storage projects in Scotland which are expected to become operational in 2025.
- ENGIE owns a gas storage facility - Storengy in Cheshire and recently acquired Ixora energy which owns 3 anaerobic digestors which supply renewable gas and electricity.
- ENGIE owns a GB retail business supplying electricity and gas to I&C customers and is very active in the corporate PPA market supported by ownership of 60MW of onshore renewables.
- Further, it is part of a J/V with EDPR which operates and develops offshore wind projects in Scotland.
- ENGIE's future GB focus is to be the market leader in flexible energy storage, to scale up the onshore renewable portfolio and to further establish its position in green gases – a GB business portfolio that is aligned with the Government's net zero ambition.

General comments

- This response covers both the Guidance consultation and the Call for Input.
- On the Guidance consultation, we welcome the clarity that this provides and have suggested some areas where this could be enhanced further.
- On the Call for Input, the TCLC has been in place since 2012 – over 10 years. In this period it has only applied to bids. In all the areas where Ofgem is seeking input for its potential expansion, it has not been evidenced that there are material problems requiring solutions. Prior to further developing any of these proposals, Ofgem needs to conduct a robust impact assessment using real data to justify why an expansion of the TCLC is needed. This should demonstrate that the lack price regulation in these areas is causing undue harm to

consumers both in the short term and also in the longer term (recognising the increasing need for flexible sources of generation to achieve net zero).

TCLC guidance consultation

The enhanced guidance is welcomed. Penalties have been applied to some generators who have been found to have breached the TCLC and this guidance helpfully sets out in one place the types of behaviour that have led to these licence breaches. This should reduce the potential for different interpretations as to what does and does not constitute a licence breach.

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

Licensed generators will need to robustly document all their pricing decisions, for example documentation of costs, of prices and deviations in those prices and of scheduling decisions. It might be useful for Ofgem to specifically outline what ought to be documented and share some best practice.

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?

The guidance says that generators must not submit bid prices at a level which would result in them obtaining an excessive benefit were that bid accepted. Ofgem also expects (para 2.35 of the guidance) that generators make a reasonable assessment of the duration of a constraint to avoid over recovering. It is rarely possible to know how long a constraint will last. – unless the TSO has clearly stated that a transmission line will be out of service for a specified period.

A generator could for example receive a benefit of £20/MWh for its bid pricing strategy. In the event that it is constrained off, para 2.35 implies that there is a duration for a constraint where the pounds earned become more relevant in the assessment of excessive benefit than the £/MWh. How does the generator assess what that limit is and over what timeframe particularly when it has no idea how long the constraint will last?

And if after a period of being constrained and concerned that Ofgem may consider that excessive profits are being made, the generator does increase its bid price, does this more positive bid price then set the benchmark for a future assessment of excessive benefit - for both this particular generator and others in the same constrained zone? Para 2.38 suggest that this is the case. Para 2.42 says that the comparator price (for determining the benchmark) should not have been submitted by the generator in relation to a constraint period. The generator will not know exactly when a constraint ends so having increased its bid price to avoid the perception of having made an excessive benefit, this price will persist for a period after the constraint ends.

Once a generator finds that its bids are being tagged, it is going to become very nervous as to how it should price bids in the future. We would welcome additional guidance as to how Ofgem would assess whether there has been a licence breach when constraints persist, what actions it would expect the generator to do with respect to its pricing if this were the case and how the suitability of its bid pricing would be assessed once a constraint has ended in the event there is a future constraint.

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

There may be physical reasons, particularly for thermal assets, whereby bid prices may deviate away from pure cost base. For example, there may be restrictions when ramping two units close together which means bids on the other unit must be avoided.

There may also be occasions whereby BM pricing may be used to manage commissioning/testing to avoid the ESO adjusting the load. If this testing happens in a constrained period then it could be flagged.

Call for Input TCLC

We have assessed each of the proposals to expand the scope of the TCLC.

As a general comment it has not been evidenced that there are material problems requiring solutions. Prior to further developing any of these proposals, Ofgem needs to conduct a robust impact assessment using real data to justify why an expansion of the TCLC is needed. This should demonstrate that the lack of price regulation in these areas is causing undue harm to consumers both in the short term and also in the longer term (recognising the increasing need for flexible sources of generation to achieve net zero).

Please see the comments below.

Prohibit licensees from obtaining an excessive benefit in relation to reductions in generation procured via other categories of balancing services, not just bids in the BM (schedule 7a / intertrips)

ENGIE does not see the need to extend the TCLC to other categories procured for balancing services for the following reasons:

- What would be in scope – all balancing services or only some balancing services? If the latter, we would question whether it is fair to exclude some types of balancing service (for example demand flexibility).
- A number of schedule 7A trades are to manage interconnector flows but interconnectors are not subject to the TCLC. It would seem unfair to require some recipients of schedule 7A trades to be subject to the TCLC and others not.

- Since these types of balancing services are taken to resolve very specific locational issues, there would be a lack of comparators to determine whether there has been an excessive benefit.
- These services are procured ahead of BM timescales for longer periods via market based tenders with prices fixed in advance of there being details of any constraints. A provider cannot quickly change its pricing as a reaction to there being a constraint.
- The economics behind different types of service providers are very different and impact on how prices are determined. As above - there would be a lack of comparators to determine whether there has been an excessive benefit.
- Intertrips are only used for short periods then the BM is used to address an ongoing problem. This does not seem to align with the TCLC focus of its enforcement on persistent pricing behaviour.
- This prohibition will also reduce the appetite to offer intertrips. Ofgem should consider the alternative to this (i.e. transmission investment) and whether this would be a preferred route.

Expanding the TCLC to offers in BM (and more widely)

We do not see the need to expand the TCLC to offers for the following reasons:

- Export constraint boundaries are well known, the same cannot be said for import constraints. These occur much less frequently and are more geographically dispersed and do not persist for long periods. This makes it very difficult for a generator to know when an offer is likely to be flagged as being taken for constraint reasons or how long the constraint will last for. If there are opportunities to exploit constraints they will be of much shorter durations
- There is an incentive for all types of generator in areas of an import constraint to generate (as this is the only way they get paid). As well as constraints being of short duration, there is much more competition for offers. This does not seem to be a structural problem in the same way that there is for bids.
- Some imports constraints are resolved using trades across interconnectors (reducing exports) but the TCLC does not apply to interconnectors. Even if it did, it would be unfair to penalise the interconnector licensee as it is the (unlicensed) capacity holder that sets the price for the interconnector's offer price. And if the TCLC is not applied to tagged offers accepted on interconnectors but is applied to tagged offers from other types of generation in the same import constrained area, this would be discriminatory.
- Market participants in any market will seek to price a homogenous product at the marginal cost of output. This is how an efficient market functions and Ofgem recognised this in its 2016 letter on scarcity pricing¹. If the TCLC is expanded to offers, each generator will be subject to an unknown (until tested by Ofgem) price cap removing price discovery and scarcity premiums from the market which as Ofgem says in its letter "should encourage investment in production or a demand side response which will be to the benefit of future energy consumers".
- Constraining prices of generators behind a constraint would pose a commercial disadvantage to those generators versus the rest of the market

¹ [scarcity pricing and conduct in the wholesale energy market.pdf \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/scarcity-pricing-and-conduct-in-the-wholesale-energy-market)

- Generators currently factor non delivery risk (which exposes them to the higher of their offer price and the cashout price) into their offer prices. If the TCLC is expanded to offers and offer prices must be limited to a level appropriate only to that generator, they will not be able price in this 'trip risk' despite continuing to have the potentially much higher cashout exposure. If Ofgem was to extend the TCLC to offers, the cashout rules would also need to be changed.

A much wider observation is that Ofgem should not be intervening to solve a problem that doesn't currently seem to be observable. One would have to create elaborate scenarios for this to be an issue in the future.

3 Expanding the TCLC to bids to import or offers to export

Expanding the TCLC to bids to import from a zero PN and offers from a $PN \leq \text{zero}$ to export would reduce the value of flexible assets and acts as a disincentive to invest in storage. It would also impact on the economics of batteries being built to alleviate constraints. Both of these issues could perhaps be addressed by higher exit bids in the capacity market but we question whether overall this is a good outcome for the consumer.

4 Changing the TCLC to a price cap on bid and offer or cap on profits in constrained periods

The generator would not know until after the event that a constraint was in force or how long it would last. To avoid being non-compliant with the TCLC, it would always have to price at or below the cap. Therefore this would not be a cap on prices or profits in constrained periods it would be a cap on pricing / profits all the time. At a most basic level, this is price regulation.

On a more detailed level, ENGIE does not see this as workable; each generator would have its own unique set of marginal costs necessitating a cap being developed for every generator on a half hourly basis. This would place a substantial and complex burden on Ofgem.

For example:

- Efficiency factors vary from one generator to the next even in the same technology class, there would need to be a bespoke mechanism for each BM Unit
- Input costs could vary on a half hourly basis. Gas prices can be particularly volatile (during the gas crisis for example) and imports costs for storage will change on a half hourly basis dependent on the marginal cost of generation. The price cap would therefore also need to vary (on a BM unit by BM unit basis) on a half hourly basis.

In addition it would not work alongside the current cashout rules - for the same reasons as given in comments on proposal 3.

And finally it is not consistent with Ofgem's forward work programme where Ofgem wishes to "deliver effective and efficient market incentives and signals". Price regulation is neither effective nor efficient for market signals.

5. Extending the requirements of the TCLC to providers of balancing services other than licensed electricity generators

Clearly it would be fair and would level the playing field if all parties taking part in the Balancing Mechanism were subject to the TCLC or something similar - not just those that have a generation licence.

It isn't clear however what route would be used to enforce this if there is no licence to attach the requirement to. Whilst for example interconnectors are licensees, if the TCLC were extended here, it could stop power flowing to the UK. It would also be targeting the wrong party – it isn't the interconnector licensee that sets the bid / offer price, it is the (unlicensed) capacity provider.

There is a more general question here. Given the market is expanding to allow participation of smaller providers for example the demand flexibility service which is impacting on market price formation, how are these to be effectively regulated?

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