

ANONYMOUS RESPONSE

[ANONYMISED] welcomes the opportunity to respond to Ofgem's call for input on whether any changes are required to the Transmission Constraint Licence Condition (TCLC) in order to ensure that it is as effective as possible in keeping down balancing costs. We acknowledge Ofgem's rationale for proposing changes to be made to the TCLC to prevent excessive generator profits during transmission constraint periods. We are broadly in favour of further protections against abuse of market power that hinders the Electricity System Operator (ESO) from managing constraints costs effectively. We however caution against changes that will impose undue restrictions on generators that participate in the Balancing Mechanism (BM) or other constraints markets outside the BM. The proposed changes may lead to unintended consequences that further exacerbate balancing costs, and ultimately, cost to consumers.

We have highlighted below initial views on the proposed TCLC changes and potential outcomes that should be given due considerations as Ofgem explores ways to effectively protect against market power or manipulative behaviours.

Expanding the TCLC to offers. This change may suppress the necessary price signal that reflects the true value of volatility and flexibility, and effective competition. This may have unintended consequences and see earlier closure of existing flexibility/storage assets or deferred investment in storage assets, whose business cases are correlated to price spreads in both energy balancing and constraint management. This may likely result in either closure of assets which in turn tightens margins that will be reflected in Wholesale Market prices or lead to higher prices in the Capacity Market; thereby increasing costs borne by consumers. There is a balance to be managed; whilst consumers should not have to pay for the extreme consequences of insufficient planning of the transmission network, it should be recognised that the services flexible assets are providing to the ESO form part of their investment case. So, if offer prices are subject to further regulation which in turn limits revenue potential of flexible assets' business cases, there is a risk of investments not going ahead or increasing revenue may be sought through higher pricing to energy or Capacity Markets.

Expanding the TCLC to balancing services used by the ESO to manage constraints other than the BM. The proposal to extend the TCLC to Schedule 7A trades and intertrip services could potentially restrict liquidity in the constraint market. Schedule 7A trades are predominantly conducted on interconnectors. If interconnector parties withdraw from this market, the ESO may have to "trade" with the connecting/neighbouring European Transmission System Operators (TSO) as a last resort. This means pricing for the constraint action will be related to offers and bids in France, Netherlands etc, and will be out of jurisdiction for Ofgem to regulate. Furthermore, there may be added complexities as not all connected TSOs have real time SO to SO trading.

The proposed changes could also dilute the price signal relating to transmission investment over the medium term. For instance, batteries can provide an important hedge against export constraint costs whilst also maximising utilisation of green electrons e.g., as per the B6

boundary. Given it takes around 14 years¹ to build a new transmission line, this could result in higher consumer costs across the medium term or slow the build out of renewable generation necessary for net zero.

Furthermore, extending the TCLC to intertrip services and imposing an explicit cap on generator prices or profits, reduces generators' incentive to contract their assets for the commercial intertrips. This service is relevant to the ESO during times of system stress and tight margin or following unplanned faults/outages. The counterfactual to the intertrip service scheme will be to build more transmission infrastructure, or to take a greater volume of pre-fault actions. Therefore, the cost of the intertrip service should reflect the avoided transmission investment cost over time, or indeed, the alternative actions taken in the BM².

Summary

In conclusion, expanding the TCLC has the potential to impact other markets such as the wholesale and capacity markets, and disrupt the fundamentals of market pricing, ultimately resulting in higher costs to consumers. Any expansion of the TCLC should consider the potential for unintended follow-on impacts. For example, for transitory constraints, or for system issues where either competition already exists, or can be brought to bear e.g., B6 boundary tender, the case for applying such a limitation on offer prices via expanded TCLC requirements is insufficient. This is because constraint pricing forms part of the revenue stack for investment. If these revenues are restricted or even withdrawn, for an investment to proceed, higher revenues would need to be captured through higher prices elsewhere.

We would therefore recommend that any changes to TCLC are considered holistically i.e., how would the imposition of restrictions on pricing behind constraints impact on an assets' economic viability. Also, consideration should be given as to how the removal of a price signal impacts TO investments.

One course of action may be to put a cap on constraint revenues over an extended period e.g., 5 years. This would provide ample time and opportunity for alternative TO investments to be considered or implemented and mitigate the impact on business cases for flexible assets. It is important that incentives on Transmission Owners are maintained, and a clear price signal is key to this.

Yours sincerely

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¹ Report from Electricity Networks Commissioner June 2023

² A recommendation to assess the role of regional flexibility markets was also made in the Winser report. It was noted that energy storage infrastructure mitigates transmission investment.