

Response to Ofgem Call for input: Transmission Constraint Licence Condition

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 respond to Ofgem's Call for Input on the Transmission Constraint Licence Condition (TCLC). Our views on the effectiveness and impacts of TCLC are set out in the introductory comments to our response to the consultation on the proposed updated TCLC guidance and we will not repeat them in detail here. In general, we consider that Ofgem's approach to the TCLC has made it very challenging for licensees to ensure compliance and there is a risk that TCLC will effectively lead to blanket regulation of bid pricing on a 'cost plus reasonable profit' basis, even when there is no relevant transmission constraint in force. This approach is inconsistent with the original intent of the TCLC to target pricing only where a generator is subject to a transmission constraint and with the principles of a competitive electricity market.

The Call for Input highlights the increased constraint management costs incurred in recent years. This is a symptom of the lack of investment in transmission network capability in the past decade, which could have alleviated many of these transmission constraints. The high costs associated with managing thermal constraints in recent years have predominantly arisen from the need to bid down expensive wind generation. Flexible storage and thermal plants, which can amend their output cost effectively, have an important role to play in helping the System Operator to manage constraints and the provision of system services is likely to be an increasingly significant revenue stream for these sorts of generators.

The Call for Input suggests that further expansion of TCLC is required to mitigate the risk of the exercise of market power by generators in light of higher transmission constraint costs. However, no evidence has been provided which shows that the risk of the exercise of market power has actually increased as the cost of managing constraints has increased. Ofgem appears to be suggesting expansion of the TCLC in a way that could limit normal competitive activity in the electricity market without any evidence that additional regulation is required. Ofgem's approach to the TCLC suggests that it intends to limit the profit that can be realised from the provision of useful system services by generators and this could

affect the attractiveness of the GB electricity market to new and existing investment, potentially encouraging the earlier closure of thermal plant, or driving up costs in other mechanisms (such as the Capacity Market or ancillary service markets).

We also question the rationale for expansion of TCLC when other powers to enforce cases of market abuse are available to Ofgem. REMIT was relatively new when TCLC was originally introduced, but is now an established and tested framework for tackling market abuse and we consider that REMIT should be suitable for addressing the sorts of abusive behaviours which Ofgem may have in mind in relation to transmission constraints. In fact, the circumstances covered by TCLC were reduced in 2017 precisely because it was considered that there were already powers under REMIT to tackle some of these circumstances. We are concerned that Ofgem would rather give itself new powers, which are based on ill-defined and broad concepts that present a challenge for licensees to interpret and comply with, rather than pursue cases via established and well-understood legislation with significant case law.

Given our concerns about TCLC, EPUKI's preference would be for the licence condition to be removed as it no longer serves a useful purpose and enforcement powers are available to Ofgem under alternative legislation. We certainly could not support the expansion of TCLC to additional services or activities in the market. However, we do consider that, if TCLC is to remain in place, it should apply to all types of market participants equally and therefore should capture non-licensed generators and interconnectors as well. We have provided some feedback below on the five options outlined by Ofgem in the Call for Input.

1. Expanding the TCLC to balancing services used by the ESO to manage constraints other than the BM

We are unclear of the rationale for this proposal. Most balancing services are procured through highly competitive tenders in timeframes which allow the ESO to seek alternative solutions if the desired service is not available at a reasonable price. Ofgem mentions the example of Schedule 7A trades, but these are negotiated trades which the ESO can choose not to enter into and procure the volume via the Balancing Mechanism instead if it believes that this will deliver a more reasonable price. Ofgem has not provided any examples whereby the ESO has been forced to procure other balancing services in a way which would otherwise be uneconomic and we are therefore not convinced that there is a requirement to regulate pricing in these other balancing services. We note that balancing services could be used to manage a wide range of system issues, of which known transmission constraints are only part. We are therefore unclear how Ofgem would determine exactly which balancing services or contracts should be subject to TCLC.

2. Expanding the TCLC to offers

The expansion of the TCLC to offer pricing would be a significant departure from the original rationale and justification for the licence condition. We consider that there is a fundamental difference between bids and offers in respect of transmission constraint periods as generators subject to bids are already self-despatching, whereas this is not the case with offers. By regulating offer pricing, Ofgem would effectively be forcing generators to turn on or deliver additional output for marginal returns. This proposal would regulate Balancing Mechanism prices to protect against some ill-defined concept of 'market power' rather than creating an environment that encourages generators to invest to deliver useful services to the System Operator.

EPUKI is concerned that Ofgem's current approach to TCLC requires generators always to price their bids on an extremely conservative basis because of the inability to know in advance when a transmission constraint is in force and to be sure how Ofgem will assess what level of profit is reasonable from bids when a transmission constraint is in force. Expanding TCLC to offers would result in exactly the same issue in respect of increases in output, effectively preventing generators from making any meaningful profit in the Balancing Mechanism, even at times of system scarcity. This would be a serious disincentive to invest in flexible plant and could lead to higher prices in other mechanisms, such as the Capacity Market or ancillary service markets.

Furthermore, we consider that REMIT already exists as a tool to address excessive offer prices submitted by generators and there is therefore no requirement for additional regulation to address any concerns that Ofgem may have about offer pricing.

Given the serious change to established principles that the expansion of the TCLC to offer pricing would represent, we consider that if Ofgem wished to make such a change then it should seek the consent of government and Parliament for its approach.

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

The regulation of bid (or offer) pricing where the generator has no ability to exacerbate a transmission constraint would be a significant change from the original purpose of the TCLC. This change would clearly result in Ofgem regulating Balancing Mechanism prices more widely to protect against some ill-defined concept of 'market power' that Ofgem believes generators could exercise when providing useful services to the System Operator. Flexible generators, such as storage, can help the ESO manage constraints when they arise on the system but the introduction of additional regulation that would limit their ability to profit from the provision of these services will disincentivise further investment in flexible capability and could therefore be counterproductive.

4. Replacing the requirements of the TCLC with an explicit cap on generators' prices or profits in constraint periods

While in principle an explicit cap could provide generators with greater certainty as to what Ofgem would find acceptable in terms of pricing during a transmission constraint period, generators would still face the problem of not knowing when a transmission constraint is in force and therefore when to price in accordance with the stated cap. This may lead to generators applying the cap to all bids and offers, even during periods where no transmission constraint is force, with the negative consequences for markets and investment that we have previously identified. Furthermore, it would be an extremely challenging task for Ofgem to calculate an appropriate cap for all types of generators and circumstances given the wide range of participants in the market.

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

EPUKI in general does not support the continuation of the TCLC. However, if the TCLC is to remain in place, it is crucial that it applies equally to all generators to ensure a level regulatory playing field. We agree with Ofgem that there could be circumstances whereby non-licensed generators could enjoy market power when a transmission constraint is in force. We therefore consider that any provisions of the TCLC should apply equally to licensed and non-licensed generators and to interconnectors and we would support the implementation of this proposal.