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By Email to: WholesaleMarketPolicy@ofgem.gov.uk

Dear Domestic Market Management Team

Call for Input to the Transmission Constraint Licence Condition

This response is the view of SSE plc (SSE) with a focus on the position of SSE's Energy Businesses, which comprise of: SSE Renewables; SSE Thermal; SSE Distributed Energy; and Energy Markets, which provides the route to market for SSE Group companies. Our response also considers the impact of balancing costs on SSE Business Energy, our non-domestic supply business which supplies energy to c.500,000 businesses and industrial consumers in Great Britain.

Increasing constraint costs are the result of delays in transmission investment. Ofgem addressed the regulatory impediment to faster transmission investment with the Accelerated Strategic Transmission Investment (ASTI) framework and as a Transmission Operator, SSE is focused on deploying new transmission network as fast as planning and supply chains allow. However, in a net-zero and renewables-based electricity system which is characterised by intermittent output, transmission constraints are likely to endure in some form.

We understand that Ofgem needs to ensure that the costs of constraints are managed to minimise the impact on consumers. Managing costs should be about ensuring that there is sufficient competition in the market, with information, e.g. on forecasts of constraints, shared to minimise market participant costs as well as reducing distortions such as those caused by support schemes.

While SSE can see that the options proposed by Ofgem could potentially reduce constraint costs in the short term, regulation is a blunt instrument and in the long term may have an impact on investment in assets that can support constraints management. It is not clear that the changes proposed would offer that support and if anything could deter investment by removing some market signals.

Alternative Options

Our response reflects the need to develop the proposals set forward, as well as other considerations. We have explored points which require further clarification and additional considerations in Appendix 1. We do also believe however, that there is merit in considering how well the TCLC is achieving its aims. Despite Ofgem making TCLC compliance a priority over the last few years and entering compliance processes with a number of generators, none of these parties were found to have deliberately breached the licence condition. This could be an opportunity to review the usefulness of regulation given it can be breached without intent, rather than extending its application further.

Additionally, the TCLC was not designed to be an enduring regulation, it was a stop-gap piece intended to address perceived risk during a period of network reinforcement. It is widely acknowledged that this reinforcement has not taken place. Therefore, resource may be better expended understanding what is needed to ensure Great Britain's net zero ambitions are not hampered by either the lack of infrastructure to manage the renewable capacity or the environment of uncertainty the regulator creates when publishing broad-ranging proposals without a clear problem statement and an accompanying impact assessment of the measures under consideration.

Conclusion

We understand that Ofgem's work on updating the TCLC is at an early stage and that the intended output is to collate industry views on the future of the TCLC. Moving forward we are keen to take this opportunity for open and collaborative discussion between Ofgem and market participants in an open forum. Discussing and exploring market issues, and possible mitigations, will provide an efficient means of sharing concerns and expectations as well as facilitating better understanding by all parties of the market context.

Yours sincerely

Roger Hutcheon

Head of Regulation – Group Energy Markets

Appendix 1 – SSE view of Ofgem Proposals

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

We are pleased that within the call for input Ofgem notes that bilateral contracts, such as Schedule 7A trades are separate to the balancing mechanism. Within the Guidance Consultation¹ Ofgem references Schedule 7A and bilateral trades, however the drafting is ambiguous making it unclear whether Ofgem continues to recognise that these contracts sit outside of the scope of the TCLC.

With reference to the proposal put forward, the key element which needs to be understood is to which balancing services Ofgem anticipates that this would apply. There are several points which we would highlight that indicate that there is limited benefit from including balancing services within the scope of the TCLC:

- Many balancing services are tendered for through a competitive process therefore are not open to manipulation.
- It is difficult to understand how service providers could respond were a circumstance to arise where they were frequently providing the service during a system constraint as it is not possible to amend the contracted price at a later period. This is especially concerning if excessive benefit is assessed on a cumulative basis, rather than in an individual period.
- While noting Ofgem is seeking to address this issue via Option 5; service providers that are not generation licensees are not subject to the obligations of the TCLC. This means there are different commercial considerations for licensees and non-licensed service providers. If this is not addressed there is a risk that generation licensees face a commercial disadvantage and therefore become unwilling to provide balancing services.

With this said however, a method of providing Ofgem the means to understand, and if necessary, challenge, National Grid Electricity System Operator's (NGESO) use of certain balancing services, particularly those which sends a signal to the market could be welcome. For example, use of the Demand Flexibility Service (DFS). NGESO should utilise this service as a last resort, however, due to the timeline of events required to enact it, it is often utilised ahead of procuring other balancing services. NGESO have paid providers of demand side response up to £6000 /MWh. This indicates a value of energy to the system. In practice, especially if proposals 1 and 2 are implemented to amend TCLC, in reflecting this inferred value in its price, a generator may be found to be seeking an excessive benefit while DFS participants who are not licenced may be able to earn this with no consequence.

2. Expanding the TCLC to offers

Ofgem has consistently noted the importance of scarcity value in the energy market. For example, in 2016², Ofgem said that scarcity is expected to be priced into the market and that the increase in price will provide a signal that investment is needed. It would be useful to understand Ofgem's perspective of when scarcity pricing is acceptable and when, especially in a situation of TCLC applying to offers, reflecting scarcity within prices is not appropriate. Without consideration of the interaction between the application of TCLC to offers there is a risk that one undermines the other.

A further consideration, arising from the need for clarification around the interaction with scarcity value is also the impact on the incentive for investment. To achieve net-zero ambitions, flexible technologies, which

¹ [Transmission Constraint Licence Condition guidance consultation - December 2023 | Ofgem](#)

² [Open letter on scarcity pricing and conduct in the wholesale energy market | Ofgem](#)

can alleviate constraints, will be needed. Again, without consideration of the whole outcome there is a very real risk that one of the consequences of extending the TCLC in this way is to disincentivise that much needed investment.

From the information within the call for input, it is not clear how this proposal would apply to various scenarios. For example, consider a period of high wind in Scotland resulting in curtailment while thermal generation is increased in the south:

- 800MW of wind curtailment in Scotland
- 1000MW of thermal generation in the South
- Would 800MW of the thermal generation be considered system action i.e. replacing the curtailed wind output while 200MW is responding to energy requirements?

In such a scenario Ofgem should also make clear how ESO is expected to treat generators that offer the same product and are in a similar location to another generator also responding to offer instructions, especially when some capacity may be required to meet generation shortfalls due to the boundary constraint while other capacity is responding to energy issues not created by the boundary constraint.

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

Before further considering this change, it would be useful to understand the problem that it is intended to resolve. Resolving outstanding issues affecting investment in the transmission system would likely do more to reduce constraint costs. Expanding the TCLC to bids to import or offers to export, more than aiming to reduce constraint costs, effectively minimises the return that generators can make and is akin to having administered prices.

As discussed in relation to Option 2 above, offer prices provide an investment signal to build. One immediate concern is that this change would have an adverse impact on storage providers. The incentive currently exists to develop storage projects, including long duration pumped storage, and it is logical to build these assets in locations where there is a proliferation of generation; there has never been an incentive to build in an unconstrained market based on underlying market fundamentals. The BM does not provide a stable revenue stream for these projects however, absent any alternative more predictable value available in the market for relieving constraints e.g. TNUoS demand credit as proposed by CMP405 / Constraint Management contracts, the flexibility offered by storage to the system must be recognised by the BM.

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

We agree that it is important that Ofgem considers the application of an explicit price cap, or at least a means of defining what a reasonable level of profit is, as well as the level at which benefit becomes excessive. This must be done as a standalone exercise underpinned by a cost benefit analysis.

Whilst we do not think the market is broken, this option would provide generators some level of protection from price shocks in the BM. However, any limit placed on market or BM prices may lead to increased costs elsewhere, for example the capacity market as generators seek to obtain the lost BM revenue via the Capacity Market. Given that the capacity auctions are cleared by the highest bid, if an asset were forced to obtain this difference from the Capacity Market, prices for all generators would increase. The typical volume purchased via the Capacity Market Auction is ~40GW a £10/kW increase could lift the overall annual cost of capacity by £400m.

The TCLC does not restrict profits and does not mandate that licensees apply a 'cost plus' method for calculating BM prices. We note there is some contradiction between this option, on which Ofgem is seeking

views through this call for input, and the drafting within the updated guidance, which is currently open for consultation. The proposed guidance is ambiguous to the extent that one possible interpretation is that the measure of reasonable, or excessive, profit is based on the generator's cumulative profits which would equate to a de facto profit cap on generation prices and profits.

Difficulties which would need to be addressed alongside a cost benefit analysis include:

- Who would administer the cap and how would it be calculated?
- How would the level be set which considered all participants' circumstances while maintaining an even playing field.
- Participants would need to be able to respond to changes in the market, meaning the cap level would need to be proportional to prevailing market conditions.
- Could the cap be developed to include an element of accounting for future prices.
- If TCLC is not extended to parties beyond generation licenses, how would the price cap apply to interconnectors while recognising that it may create scarcity issues which will also need to be addressed (e.g. if GB prices are too low, GB exports may increase and/or energy from France may instead be diverted to Italy or Spain)?

SSE indicated during the consultation phase, ahead of the implementation of IOLC, that it is intrigued by this type of proposal. Our view is that, by its very nature, this intervention carries the risk of negative impacts on price signals. It would be the most likely, of the options proposed, to address high balancing costs if a workable approach could be found. It could also encourage investment if the price were set at an appropriate level. However, that would require a market reform that comes close to regulated returns for generators and so it is not clear how it could be developed in isolation from the Government's ongoing Review of Electricity Market Arrangements.

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

In addressing constraint costs the focus should not solely be on generators, and specifically generation licence holders. We welcome recognition of this by Ofgem. Where regulation has a narrow focus, opportunities to address rising costs will be missed, the impact of possible solutions dampened and overall could lead to a number of other unintended outcomes.

REMIT offers Ofgem the power to ensure all market participants are behaving in an appropriate manner. While we recognise that the analytical framework is different across Ofgem's various regulatory powers this should not be a barrier to recognising and treating all market participants in the same way, especially when behaviours negatively impact consumers.

Before extending the requirements of TCLC in this way, it would therefore be helpful for market participants to understand the range of behaviours that this measure would seek to address. If there is a concern that prices for balancing services do not reflect the normal interplay of supply and demand then that is an area that may already be covered by Article 5 of REMIT, which prohibits market manipulation. If the concern is that costs are simply too high, despite reflecting competitively determined prices, then it is not clear that this can be resolved via regulation without a more radical reform of the market for balancing services.