

# Ofgem Call for Input on the Transmission Constraint Licence Condition

Energy UK response

February 2024

## About Energy UK

Energy UK is the trade association for the energy industry with over 100 members – from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology. Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity across energy.

## Contact

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## Executive summary

Energy UK welcomes the opportunity to respond to this 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.

At a time of significant pressure on consumer bills, Energy UK recognises that it is especially important to ensure that regulation works effectively to protect consumers from the impact of market abuse. However, we note that proposals considered in this Call for Input could introduce fundamental changes to the market, which could have a knock-on impact on investor confidence and other areas of the industry and therefore must be considered carefully.

It is important that the premise for introducing any changes is data-driven and based on clear evidence showing that the changes would lead to a demonstrable outcome on lowering balancing costs. We note that there has been no Cost Benefit Analysis or an impact assessment of the TCLC since 2011. We are concerned that there has been no evidence or

analysis provided to support changes considered in the Call for Input, or at the very least, an assessment on whether TCLC is effective in its current form. Indeed, a few members questioned whether the TCLC was in itself at all required to address market abuse, suggesting that REMIT sufficed for this purpose.

As this stage, Energy UK is not convinced that changes to the TCLC would deliver benefits. It is unclear how these proposals would work in practice, which members have emphasised makes it difficult to properly understand the commercial impact they would have. Furthermore, we are concerned that the proposals in this Call for Input have been developed without sufficiently taking into account wider policy objectives or system needs, in particular due the negative impact that some of the changes could have on investment and the development of flexibility.

Ofgem should hold workshops to offer industry the opportunity to understand the objectives of the changes considered and what they would look like in practice. Energy UK would be happy to facilitate this kind of engagement.

There may also be more appropriate mechanisms for achieving the objectives considered in this Call for Input, such as the work being undertaken by REMA. The update to the TCLC guidance considered in the accompanying consultation may also bring benefits – Ofgem should review whether this has had an impact before considering further changes.

If Ofgem decides to progress any of these changes, this must be undertaken in a clear and considered manner with all the data and information provided in advance of change to ensure that parties have sufficient time to align the new approach.

### **Views on specific options**

#### **Option 1 – Expanding the TCLC to Balancing Services used by the ESO to manage constraints other than the BM**

Energy UK believes that there is too much uncertainty about the potential impact of extending TCLC to Balancing Services. A number of key questions would need to be addressed before a decision could be taken to expand TCLC to Balancing Services:

- What is within scope of Balancing Services? What services does Ofgem anticipate this would cover? Would it extend to the Demand Flexibility Scheme?
- Is there any evidence or data from the ESO that parties providing Balancing Services hold a position of market power that needs to be addressed via the TCLC rather than through REMIT? If future evidence suggests an issue, then Ofgem should revisit the subject and/or make use of existing powers under REMIT and artificial pricing.
- Where there is a tender process as part of the services, will Ofgem provide feedback on bids to assure service providers that they will not fall foul of a TCLC test of reasonable and excessive at some future point?

As Balancing Services are competitively procured in advance and bilaterally agreed, and this brings more certainty to both parties enabling effective planning leading to lower costs. Therefore, it is not clear how this could lead to market abuse. The ESO would be able to pursue alternative options to manage system issues if it considered that the offers received through Balancing Service tenders would lead to uneconomic outcomes.

Furthermore, we note the potential impact this could have on new or developing services. The original rationale for not including offer prices within the scope of TCLC was to preserve the investment signals that would ultimately benefit of consumers – similar considerations should apply for this proposal.

### **Option 2 – Expanding the TCLC to prohibit licensees from obtaining an excessive benefit in relation to offers.**

Some members have expressed that there is some basis for expanding the TCLC to offers in the Balancing Mechanism but not Balancing Services more broadly, citing that it would be a natural extension of current rules as, in general, a transmission constraint will require both generation to be bid off and some replacement generation offered on.

It is, however, not clear whether this is a material issue. Ofgem has already proposed changes to address high costs through the Inflexible Offers Licence Condition. Before expanding the TCLC, Ofgem should provide analysis to determine whether this is likely to be a material issue in the future.

Some members have highlighted that the application of the TCLC to offers would mark a change in the rationale and justification of the TCLC. At present, TCLC targets circumstances where generators have already scheduled to run, but extending TCLC to offers would regulate prices for increases in output, potentially forcing generators to run for limited returns. Other members noted that if additional restrictions were to be placed on offer prices, it might more appropriately sit within a revision to the IOLC.

We refer to an Ofgem letter<sup>1</sup> on scarcity pricing and conduct in the wholesale energy market which outlines that rules on market conduct are not intended to interfere with the proper application of market forces, nor do they prohibit a rise in market prices.

### **Option 3 – Expanding the TCLC to bids to import, or offers to export**

Energy UK has serious concerns that expanding the TCLC to bids to import or offers to export as this could have an adverse effect on storage. Currently TCLC explicitly excludes batteries when they are importing. The effect of the proposed change to the TCLC is unclear but could be perceived by battery developers to reduce the value of their flexible assets with negative effect on investor confidence. It may act as a disincentive to invest in storage and could result in the stalling of much needed projects. Indeed, this appears to stand in contrast with the 10GW of battery storage connections being fast-tracked by the ESO. Moreover, members have raised concerns that this proposal could have a broader impact on the investment community.

Energy UK is concerned that that this proposal goes much beyond the objective of the TCLC, targeting situations where a licensee is not causing or exacerbating a constraint, and we would urge Ofgem to conduct a Cost Benefit Analysis before progressing it any further. Furthermore, members shared that the impact of this change to the TCLC could materialise elsewhere, potentially leading to higher prices in the Capacity Market.

Members have also flagged overlaps with REMIT and that greater clarity is needed on the respective overlapping obligations. Ofgem should provide greater clarity on the respective overlapping obligations to ensure consistency of approach.

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<sup>1</sup> [Scarcity pricing and conduct in the wholesale energy market](#), Ofgem letter, December 2016

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

This would be a significant change to the Balancing Mechanism. While it could provide regulatory certainty to the market and help reduce non-compliance with TCLC, Energy UK is concerned that this would be very difficult to administer in practice, that complexity would greatly increase and as a result place a serious and complex administrative burden on both participants and Ofgem.

Ofgem should consider the following:

- Would this be a £/MWh cap or a profit cap? How would the cap be calculated?
- How would this be administered?
- How would the cap respond to market changes?
- Would this drive BM prices down or encourage them to converge at the cap level?
- The transition to Net Zero calls for a significant amount of investment in innovation, has Ofgem considered whether this initiative could deter investors?

At present, there appears to be little evidence to support an intervention like this and materially change the approach to TCLC.

Furthermore, the TCLC is not intended to disadvantage generators behind a constraint in such circumstances as the level of profit constrained generation were able to earn, if this were not reflected on all generation it could pose a commercial disadvantage to generators operating behind a constraint. Some members highlighted that option would seem to be incompatible with certain categories of generators that are built by design to operate infrequently and warrant higher associated costs.

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

In principle, Energy UK understands why a party that could potentially influence prices during a transmission constraint should not be exempt from the TCLC, and applying TCLC or equivalent to all parties that have some degree of market power due to transmission constraints would help create a level playing field among participants.

However, it is not clear how this would practically be implemented, to whom it would apply, how it would be enforced on non-licensed parties, and importantly, whether at this stage there is a material problem requiring a solution. Energy UK is concerned that, by applying additional burdens, this could negatively impact markets that are in early stages of development such as demand side flexibility. Some members noted this proposal stands in contrast to wider government and industry efforts to develop flexibility markets.

Furthermore, Ofgem should consider how this would be enforced on parties such as interconnectors, which are European-based and would not necessarily need to comply with UK-based rules governed by Ofgem.