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Dear Marta

E.ON's answers to the questions set in Ofgem's consultation on the future of the Transmission Constraint Condition

Thank you for the opportunity to comment on the future of the Generation Transmission Constraint Licence Condition (TCLC). Our answers to your questions are enclosed and are provided on behalf of the E.ON SE Group of companies.

We have answered the questions in the belief that REMIT delivers a more robust and non-discriminatory prohibition on market manipulation than the TCLC and is more helpful from a customer and investor perspective. On this basis we argue that TCLC is not required and should not be continued beyond 2017.

If you wish to discuss any of the answers provided please do not hesitate to contact us.

Yours sincerely

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Question 1: What are your views on the impact of TCLC on the behaviour of market participants?

As a market participant that operates both conventional and wind powered generation plant the introduction of the TCLC has had little impact on us. Given competition law has for many years prohibited the abuse of a dominant position, our approach has and continues to be to assume that abusing a natural monopoly position within a transmission or distribution system constraint is illegal. The introduction of the TCLC did not change this view.

We believe that since the first discussions on a TCLC and the costs resulting from excess generation within a particular transmission zone, the issue and awareness of negative prices has become better understood across the whole industry. We believe it is this better understanding of negative pricing and what should be done that has resulted in a lowering of cost. The lowering of cost is unlikely to be due to the presence of the TCLC, a licence condition that does not apply to all generators.

Question 2: What have been the costs for generators to comply with TCLC?

Our experience is that there has not been a direct significant cost for generators complying with the TCLC, as they already had to comply with competition law. There has been the direct cost of operating procedures to ensure that if there is a time when a plant could be contributing to a system constraint there is clear evidence retained, which explains why the plant had the particular price at that time.

The introduction of the TCLC has also added to the list of risks that potential new entrant generation licensees have to face, so increasing further the cost of new entry. This particular risk being that post event it can be determined that the licensee's plant was contributing to a transmission constraint and that the licensee secured excessive benefit from the transmission constraint, even though the licensee was unaware that it had plant contributing to a constraint.

Question 3: What have been the benefits of TCLC?

There are no obvious benefits for customers, in terms of prices and security of supply, arising from having the TCLC. As explained in our answer to Question 1, the lowering of average costs for negative bids now being experienced is probably through greater awareness and understanding of negative pricing. In general the lowering of cost is unlikely to be due to the presence of a licence condition that does not apply to all generators.

Question 4: Should the scope of TCLC be widened to include licence exempt generators participating in the BM?

We do not believe that the TCLC is required. Notwithstanding this, if it is felt that it is

needed for licenced generators then its requirements should apply to all generators that can receive payment for reducing load, or be in the position of benefiting from constraints. This is regardless of how significant a particular plant can be to the overall cost. There should not be a level of deemed excessive benefit that customers have to fund because it is not classed as significant. There are many "not significant costs" that are being incurred by the industry that together are imposing significant cost on customers.

Question 5: What are your views on extending TCLC until 2019 in its current form as allowed by current legislation?

Given that we believe that the TCLC, as written, should not have been introduced, we believe that it should be withdrawn at the earliest opportunity and therefore should not be extended until 2019.

Question 6: What are your views on extending TCLC beyond 2019 with a further review after five years?

As with our answer to Question 5, we believe that the TCLC should be withdrawn at the earliest opportunity and therefore should not be extended beyond 2019. Further, changes in the market and advances in technology mean that customer involvement, in the form of demand side management, is increasing rapidly. While REMIT probably has sufficient scope to cover future actions on the demand side, a generation licence condition aimed at preventing market manipulation involving transmission constraints risks becoming increasingly out of date and a relic that could conflict with the clarity of REMIT.

Question 7: What are the risks and benefits of introducing an extension of TCLC?

We are of the view that the TCLC is a licence condition that as currently written does not bring any benefits to customers.

As explained in our answer to Question 2, TCLC in its current form places another unnecessary risk on generators. The total cost of the unnecessary risks means potentially higher costs to customers and a lowering of future security of supply.

A TCLC applicable to all generators with better drafting could potentially offer benefit, if other legislation did not already exist. However, REMIT is now fully operational and, for the reasons given in our answer to Question 9, provides a much more robust prohibition on market manipulation than the TCLC does. Consequently, any perceived benefits that the TCLC could have brought over competition law are now realised as actual benefits through REMIT.

Question 8: Do you have any concerns around TCLC you want to raise?

We understand that the TCLC was brought in as an attempt to address the costs being incurred around known constraints and to prevent over recovery when wind powered generation had to reduce load because of transmission constraints. Unfortunately for customers the TCLC is very subjective and limited to the single prohibition of obtaining an excessive benefit from electricity generation during a Transmission Constraint Period through involvement with the transmission constraint that created the Transmission Constraint Period. Breach of the licence condition is by exceeding a subjective value of "excessive" through either:

- manipulation of the transmission constraint and being either paid or seeking to be paid a subjectively measured "excessive" amount; or
- either being paid or seeking to be paid a subjectively measured "excessive" amount to reduce load at the time of a Transmission Constraint Period.

Consequently the TCLC fails to address in a proportionate manner the costs being incurred by customers as a result of abuse from being located within a system constraint. However, while failing to fully address the concerns TCLC introduced unnecessary risk on generators, the cost of which is inevitably being borne by customers.

Question 9: What are your views on the interactions between TCLC and REMIT Article 5?

Actions such as adjusting generation to create system constraints are just one of many forms market manipulation. Article 5 of REMIT (the prohibition on market abuse in the electricity and gas markets) delivers across Europe a consistent, robust and non-discriminatory prohibition on market manipulation. The TCLC does not deliver either a robust or non-discriminatory prohibition on such market manipulation.

When comparing REMIT and the TCLC:

- REMIT applies to all generators; the TCLC only applies to generation licensees.
- REMIT Article 5 states that "*any engagement in, or attempt to engage in, market manipulation on wholesale energy markets shall be prohibited*"; the TCLC is limited to requiring that "*the licensee must not obtain an excessive benefit from electricity generation in relation to a Transmission Constraint Period*". This means that while REMIT prohibits any engagement in, or attempt to engage in, market manipulation, the TCLC permits engagement in, or attempting to engage in market manipulation for benefit, provided the licensee does not secure excessive benefit.
- Under REMIT market manipulation, such as abusing a position of strength within a transmission constraint, is clearly defined with a clear measurable. Here market manipulation means "*secures or attempts to secure, by a person, or persons acting in collaboration, the price of one or several wholesale energy products at an artificial level, unless the person who entered into the transaction or issued the order to trade establishes that his reasons for doing so are legitimate and that*

that transaction or order to trade conforms to accepted market practices on the wholesale energy market concerned". The TCLC's "excessive benefit" is a subjective judgment and only prohibited if certain tests have been passed, some of which are also measured against the subjective judgment of "excessive".

Question 10: What are the risks and benefits of relying on REMIT to address the behaviours prohibited by TCLC, as compared to the risk and benefits of keeping the TCLC?

In summary:

- there are few, if any, risks in relying on REMIT to address the one prohibition of the TCLC;
- there is benefit to be gained from relying on REMIT to address the intended behaviours prohibited by the TCLC;
- there is risk in keeping the TCLC; and
- there are few, if any, benefits of keeping the TCLC.

REMIT is applicable to all generators and covers the wider prohibition on market manipulation. This makes REMIT better at addressing the objectives set for the TCLC than the TCLC itself does.

The risk in keeping the TCLC is that its retention perpetuates the discrimination against generation licensees and the risks associated with what constitutes "excessive". If the TCLC were retained these risks would remain, while at the same not adding anything to what REMIT now covers, namely the objective of preventing market manipulation in relation to transmission constraints. Consequently, while there is benefit to be gained from relying on REMIT to address the intended behaviours prohibited by the TCLC, there are few, if any, benefits from keeping the TCLC. Equally there are few, if any, apparent risks in relying on REMIT to address the one prohibition of the TCLC, but clear risks in keeping the TCLC.