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Consultation on the future of the Transmission Constraint Licence Condition

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy was highly supportive of the introduction of the Transmission Constraint Licence Condition (TCLC) in 2012 and would support its retention up to 2019 followed by a further review of its effectiveness.

The TCLC's main strength is that, it is a specific regulatory tool for addressing specific behaviour in clearly defined circumstances. Our main arguments for supporting its retention are:

- We believe the licence condition has been effective in reducing bids accepted by the SO (as demonstrated in section 3). This is strong evidence to suggest that constraint gaming present in the market before 2012 has been all but eliminated.

- We see no reason to think that constraints will suddenly cease to be a problem after 2017 and therefore no convincing case for removing the condition.

- The TCLC's legal test based on an "objective justification" of bidding activity is a particularly effective discipline for generators to develop bidding policies. In doing so the TCLC has helped to prevent incorrect dispatch and distortive wealth transfers between industry players. It has encouraged generators to consider price formation and bidding behaviours.

- More generally, the TCLC has the second order impact of helping generators comply with competition policy and financial regulation.

- In terms of the relationship between REMIT and the TCLC, we observe that REMIT requires a consideration of pricing strategy in relation to the market. In contrast, the TCLC requires a generator to focus on its own costs. In this way REMIT and the TCLC do not overlap even though they may both seek to prevent unnecessarily high prices and may therefore appear superficially similar.

Finally, we firmly believe that exempt generators participating in the BM should also be subject to these provisions as they have the opportunity to profit from constraints.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Angela Hepworth

Angela Hepworth
Corporate Policy and Regulation Director

Attachment

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EDF Energy's response to your questions

Q1. What are your views on the impact of TCLC on the behaviour of market participants?

We believe that the TCLC has had a positive impact on bidding behaviour. The objective justification test used in this condition forces generators to consider the rationale behind their bidding policies.

Q2. What have been the costs for generators to comply with TCLC?

The costs associated with the TCLC were around developing policies and compliance work as no IT changes were necessary. The costs experienced are now largely sunk and are negligible in comparison with mandatory market making and European financial regulation obligations.

Q3. What have been the benefits of TCLC?

TCLC has three main benefits:

1. The licence condition has been effective in reducing bids accepted by the SO and eliminating constraint gaming present in the market before 2012.
2. As a consequence of the above, in its operation the TCLC has encouraged economic dispatch and prevented distortive wealth transfers between generators.
3. More generally the TCLC has helped generators comply with competition policy and financial regulation

Q4. Should the scope of TCLC be widened to include licence exempt generators participating in the BM?

Yes. We see no reason why a party that could potentially influence prices should be exempt from the TCLC.

Q5. What are your views on extending TCLC until 2019 in its current form as allowed by current legislation?

Q6. What are your views on extending TCLC beyond 2019 with a further review after five years?

Given the effectiveness of the TCLC, we would support its extension to 2019 with a further review at that time. As indicated under Q4, the TCLC should also apply to licence exempt generators.

Q7. What are the risks and benefits of introducing an extension of TCLC?

We see no downside risks. The main benefit is that generators in dominant position will not be able to extract rents from other generators during times of system constraint as was possible before 2013.

Q8. Do you have any concerns around TCLC you want to raise?

The TCLC does not apply to exempt generators in the BM. This oversight should be rectified though we see that this may not be straightforward.

Q9. What are your views on the interactions between TCLC and REMIT Article 5?

We do not see REMIT as a close regulatory substitute. REMIT requires a consideration of pricing strategy in relation to the market. In contrast, the TCLC requires a generator to focus on its own costs. The key differences are summarised in table 1:

REMIT (market centric)	TCLC (firm centric)
Differences in concepts of Pricing	
REMIT has the concepts of "Price positioning" and "artificial prices."	TCLC has the more precise concept of "excessive prices".
Differences in the boundaries of regulatory oversight	
REMIT is a comparison of trading data and "pure market" activity. This can occur in both future and spot markets reflecting both actual and perceived supply and demand.	TCLC is based on understanding price formation including input costs, availability on the balancing market only.
Differences in evidential standards	
REMIT applies to forward markets where there are only vague fundamentals if at all (e.g. for prices quoted for seasons a year in advance). To show that behaviour does not amount to the REMIT offence of price positioning a REMIT market participant has to show that the trader had a legitimate reason for their behaviour **and** that it conformed to accepted market practices on the market (AMP). REMIT covers accidental abuse i.e. there does not have to be intent.	TCLC only covers within day pricing activity in with fundamentals. Objective pricing allows for the collation of material built from the bottom up based on real life market conditions.

In summary, the concepts of artificial and excessive prices are very different and require regulatory tools devised for different *activities* even if the effect of higher prices is the same.

Q10. 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?

The TCLC provides a clearer legal test than REMIT for firms to comply with.

EDF Energy
June 2016