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Dear Marta,

Consultation on the future of the Transmission Constraint Licence Condition

SSE welcomes the opportunity to respond to this consultation and to engage with Ofgem on its wider review of the future of the Transmission Constraint Licence Condition (TCLC).

When TCLC was introduced its purpose was to prohibit generators from abusing transmission constraints by either creating or exacerbating them in order to obtain benefit in the Balancing Mechanism (BM) or by taking advantage of their position behind a constraint by seeking excessive payments from the System Operator to reduce running. Whilst we consider that TCLC has likely been beneficial in deterring this type of activity, we believe that it has also resulted in some adverse consequences. Specifically, we consider that the way TCLC is administered/enforced creates an unlevel playing field for transmission constrained generators. Ofgem's requirement for constrained generators to justify that their prices are economical goes beyond what TCLC intended to deliver and places additional burden on these generators compared with those not constrained. TCLC was never intended to create a cap on the prices that could be sought by constrained generators nor was it intended to treat constrained generators in a different way from non-constrained generators.

We believe that Article 5 of REMIT draws sufficient parallels with the type of activities TCLC was intended to prohibit and should supersede the requirement for TCLC.

However, if the decision is made to extend TCLC to 2019 or beyond then Ofgem must ensure the following changes and clarifications are made in order to create a level playing field between constrained and unconstrained generators:

- TCLC should be widened to include licence exempt generators.
- Circumstance 1 should be removed as it is a duplication of Article 5 of REMIT but is limited in so far as it does not penalise generators from attempting to create or exacerbate a constraint.
- Clarification that generators behind an export constraint are not prohibited from pricing competitively to generation which is not constrained.
- Clarification that generators who find themselves behind an export constraint are not required to amend their bid prices when they become constrained compared to when they are not.

Our detailed responses to the consultation questions are set out below.

We would welcome further engagement with Ofgem on this matter as it progresses with this review.

Yours sincerely,

Lois Wares
Regulation

Consultation questions

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

Given that both TCLC and REMIT have been in effect over the same period it is difficult to determine what impact each regulatory intervention has had in its own right. Additionally, whilst TCLC was introduced to address Ofgem's concerns in relation to the potential for generators to abuse transmission constraints, it shouldn't be assumed that such activity was prominent in the market before TCLC was introduced. It is therefore difficult to determine what impact TCLC has had on the behaviour of market participants. We do consider, however, that the introduction of TCLC has created a significant level of uncertainty in the market which of course has affected generator behaviour and likely resulted in much more conservative pricing by constrained generators competing in the BM. We do not believe that this is a positive change however.

We note Ofgem's analysis that the prices taken by the System Operator to reduce generation from windfarms have fallen since 2012 and that whilst this may be attributable to other factors TCLC is considered to have contributed significantly to these savings. Whilst it is probable that TCLC has had an impact on generator's pricing behaviour in the BM, the impact of other factors should not be considered less significant. For example, experience of curtailed generation has led generators to take a more conservative position regarding the indirect costs of curtailment, such as maintenance costs and subsequent energy loss risk, resulting in reduced bid prices.

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

The lack of clarity around how TCLC is enforced has created significant uncertainty in the market, specifically towards generators who are affected by export constraints (Circumstance 2).

When evaluating a potential case under Circumstance 2 of TCLC there is no assessment of whether the generator intentionally attempted to take advantage of their position behind an export constraint. We consider this to be a significant shortcoming and one which undermines the intention of the licence condition, which was to prohibit generators from trying to abuse transmission constraints.

There are a number of reasons why a generator will decide to change its bid prices when it is behind a constraint, other than to attempt to abuse their position.

We would clarify that given the way in which transmission constraints are tagged by the System Operator, it would be difficult for a generator to proactively and successfully take

advantage of their position behind a transmission constraint. This is because the event is tagged as 'system' (constrained) ex-post. A generator may have changed their price to reflect competitive bids in the market only to discover post event that they were tagged as 'system' whilst the other generators were tagged as 'energy'. Similarly a generator may decide to change their bid price to reflect conditions at the station at the time (e.g. operational or environmental conditions requiring them to continue running) only to subsequently discover that they were behind an export constraint. In both circumstances the generator has not attempted to abuse their position behind a constraint, they have reacted to competitive market conditions and changing station dynamics and this has been reflected in their bid price. The additional factor whereby they find themselves caught behind an export constraint is not necessarily taken into consideration and as such in principle the generator should not be found to be in breach of TCLC.

In practise, however, the uncertainty introduced through TCLC means that generators who frequently find themselves behind a constraint do not feel confident that they are able to price as they would if they were not constrained or to compete with unconstrained generators. As such we consider TCLC has come at a cost to these generators.

Question 3: What have been the benefits of TCLC?

We expect that the introduction of TCLC and REMIT has resulted in greater awareness and consideration of market practises by participants.

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

We consider that Article 5 of REMIT already prohibits all market participants, including licence exempt generators, from uneconomically dispatching and excessive pricing.

However if TCLC were to be extended then we believe it should be widened to include licence exempt generators who are participating in the BM. This will ensure that all generators face the same level of enforcement risk for their activities in the market.

In its consultation Ofgem notes that the number of licence exempt windfarms participating in the BM is low therefore they do not have a significant impact on average prices overall. We do not consider that this is a justifiable reason for allowing some generator's behaviour to not be monitored under TCLC or any equivalent regulatory requirements.

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

For the reasons outlined elsewhere in our response we do not believe there is a requirement to extend TCLC until 2019, however if an extension is made then we believe steps will need to be taken by Ofgem to ensure the licence condition does not continue to create a barrier to constrained generators competing in the market.

Question 6: What are your views on extending TCLC beyond 2019 with a further review after 5 years?

We do not believe a clear case has been made by Ofgem to justify an extension of TCLC beyond 2019.

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

We have outlined our concerns when responding to other questions in this consultation. Please refer to our responses for further details.

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

Whilst the drafting of the licence condition is quite simplistic, Ofgem's supporting guidance has created some uncertainty on how licensees will be treated when a transmission constraint occurs. This risks creating an unlevel playing field for generators bidding behind a constraint.

Under Circumstance 2 generators should not be penalised due to their location on the network and subsequent constraints which are beyond their control. Specifically, TCLC should not prohibit a constrained generator from placing bids which differ from those of a non-constrained generator nor should it prevent a constrained generator from placing bids similar to a non-constrained generator.

Under Circumstance 1, Ofgem's TCLC guidance suggests that arbitrage is not prohibited when determining dispatch prices during periods of non-constraint but that during periods of transmission constraint a generator's dispatch plans must be economic unless they meet Ofgem's assessment that they are objectively justifiable. This guidance doesn't align with Article 5 of REMIT which prohibits a market participant (such as a generator) from securing or attempting to secure prices at an artificial level under any conditions. Based on this guidance it also is unclear how Ofgem would assess a generator's dispatch decisions at Day-Ahead when there is no constraint but then a constraint occurs. We consider that REMIT provides a much stronger and clearer message on what behaviour is prohibited in the

market and importantly that this behaviour is prohibited regardless of the conditions at the time or the resultant outcome.

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

We agree with Ofgem's assessment that Circumstance 1 of TCLC has parallels with the definition of market manipulation in Article 2(2)(a)(i) and (ii) of REMIT. We would disagree that there are parallels with Article 2(3)(a), purely because Circumstance 1 of TCLC does not prohibit the behaviour of attempting to create or exacerbate a constraint; a generator will only be found in breach of Circumstance 1 of TCLC if they create or exacerbate a constraint and then attempt to gain revenue in the BM. Therefore if their attempt is not successful (i.e. the constraint is not created or exacerbated) then they cannot be found to be in breach of TCLC. In principle however, we agree that Article 5 of REMIT interacts closely with Circumstance 1 of TCLC, with REMIT prohibiting the same activity but to a much greater extent. Therefore we believe there is a clear case for making Circumstance 1 redundant.

We consider that Circumstance 2 of TCLC has parallels with the definition of market manipulation under Articles 2(2) and 2(3) of REMIT, in so far as TCLC prohibits licensees from obtaining an 'excessive' benefit, whilst Article 5 of REMIT prohibits market participants from securing prices at an 'artificial' level. We would welcome further guidance from Ofgem on the distinction between a price which is 'excessive' and one which is 'artificial' and whether it is considered appropriate for generators to obtain an excessive benefit if they are not behind a transmission constraint. Our assumption is that this is not acceptable and that the ability for a generator to obtain excessive or artificial prices is prohibited regardless of the conditions in the system at the time. This leads us to conclude that the prohibitions under TCLC are covered by the prohibitions under Article 5 of REMIT.

We note under paragraph 5.4 of the consultation the statement that under TCLC the threshold is whether actions are 'economically justifiable' and that it is not necessary to prove that a price is at an artificial level. We would query the basis of Ofgem's assessment based on our following understanding of TCLC:

- Circumstance 2 of TCLC does not require an assessment of whether a licensee's bids in the BM are economically justifiable. The term economically justifiable is not included in the Transmission Constraint Licence Condition, it is included in Ofgem's TCLC guidance and relates to Ofgem's assessment of a licensee's dispatch decisions in relation to Circumstance 1, i.e. whether a licensee dispatches or withholds plant when it had more economic options available to it (unless an alternative objective justification can be provided) in order to create or exacerbate a constraint.
- Under Circumstance 2 the term 'excessive' is used. Ofgem's assessment of what would be considered an excessive bid is based on a mixture of considerations,

including avoidable costs, comparable generator bids not behind the constraint, and historical bids during non-constrained periods. This is not an assessment of whether a bid is economically justifiable; it is an assessment of whether the bid is excessive when measured against a number of parameters, most importantly including non-constrained bids.

The principle behind Circumstance 2 of TCLC is that a generator should not be able to take advantage of being behind an export constraint by placing excessive bids in the BM. This does not mean that a generator must place bids which differ from non-constrained generators (i.e. that it should be any more restricted due to its location on the system) or that it should be more conservative in its pricing approach when it is behind a constraint compared to when it is not constrained (i.e. that it should change its bids if it becomes constrained). These principles were emphasised by Ofgem during its stakeholder workshop on 3 May. We are concerned that this consultation is not aligned with these principles given that paragraph 5.4 suggests that generators behind a constraint must ensure that their bids are economically justifiable, while a similar requirement is not in place for non-constrained generators.

Article 5 of REMIT prohibits all market participants from entering into transactions to secure prices at an artificial level which in itself prohibits the activity described in Circumstance 2 of TCLC by preventing any generator, regardless of whether they are constrained or not, from obtaining an excessive benefit.

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?

The most apparent benefit of relying on REMIT to address the behaviour prohibited by TCLC is that REMIT applies to all 'market participants', thus includes licence exempt generators and non-constrained generators. Whilst we consider that Article 5 of REMIT prohibits the same activity and therefore all market participants should be deterred from carrying these activities, the additional scrutiny TCLC places on generators affected by export constraints cannot help but make these generators more conservative in their approach in the market.

In addition, we believe that relying on REMIT only reduces regulatory uncertainty as having REMIT and TCLC in place is at odds with the principles of better regulation which should avoid distinct regulations prohibiting the same behaviour.

Circumstance 1

TCLC is limited in its ability to deter the activity described in Circumstance 1 as a generator will only be found in breach of TCLC if its dispatch decisions have successfully created or exacerbated a constraint, not if their activities attempted to create or exacerbate a

constraint. Article 5 of REMIT is more deliberate in its drafting in so far as it prohibits any activity which manipulates, or attempts to manipulate, the market. Additionally, under TCLC a generator could create or exacerbate a constraint but then not fall behind this constraint (as determined by the System Operator), allowing it to subsequently obtain bids or offers in the BM without being in breach of TCLC. We consider the scope of REMIT to be more effective in deterring the activity described in Circumstance 1 as it goes further by prohibiting the attempted activity and also includes no provision that the generator must then attempt to obtain value in the BM.

Circumstance 2

TCLC in its purest sense should be effective in prohibiting the activity described in Circumstance 2, in so far as it should be a deterrent to generators from deliberately abusing their position behind an export constraint. In order to be effective, however, a clear assessment criteria is required to determine whether a generator has abused this position. This does not currently exist under TCLC. Currently TCLC is enforced in a way which means constrained generators must evidence that their prices and any subsequent change are justifiable, whereas non-constrained generators are not required to provide this justification. There is a risk that retaining TCLC over REMIT risks skewing competitive pricing activity in the market, ultimately to the detriment of consumers. REMIT, however, prohibits all market participants from attempting to obtain excessive or artificial prices in the market and is therefore more effective in its purpose to prevent abusive behaviour in the market.