

01 February 2024

By e-mail to TCLC@ofgem.gov.uk

Dear Graham,

Please find below VPI's response to Ofgem's Consultation on updating the Transmission Constraint Licence Condition guidance.

[VPI](#) provides flexible and reliable power to help bridge the gap between the now and the next. We operate 3.5GW of capacity across GB and Ireland with a further 624MW under construction.

We welcome updates to guidance to improve industry understanding of the TCLC in practice. We feel that some elements of the guidance remain unclear, and have made some suggestions we feel could provide additional support to the industry and reduce unintended outcomes of the TCLC.

I'd be happy to discuss any element of our response.

Kind regards,

Peter Frampton

Market Compliance and Regulation Officer

VPI

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VPI's response to Ofgem's consultation on updating the TCLC guidance

Q1. Are there additional areas of background that respondents would find it useful to have covered in the guidance?

No response.

Q2. Are there areas where respondents consider that the guidance would benefit from additional detail on Ofgem's interpretation of or approach to the enforcement of the TCLC?

The visibility of constraints has not improved in any way useful to the determination of whether a Bid may be related to a constraint. Generators are in no better position to determine likelihood of a Bid being related to a constraint than they were when the TCLC was introduced.

Therefore, Ofgem should provide more detail on the methods it thinks market participants should use to determine whether they are likely to be subject to a constraint at the point at which they submit Bid prices, bearing in mind;

- Gate closure for Bid price submission is an hour ahead of real time.
- Constraints are dynamic, and dependent on factors which change in real time.
 - o A period with a constraint will not necessarily be followed by another, and vice-versa.
- National Grid does not publish real-time data on constraints.
- That the guidance notes that an absence of a system flag on a bid (which can in any case only be known ex-post) does not necessarily mean the absence of a constraint.
- Speculative and non-Balancing Market capacity continues to trade wholesale power beyond the FPN gate closure, up to real-time.

Q3. Are there any areas where respondents consider that the proposed changes to the guidance are unclear?

We believe the application of the guidance in the context of the statement that 'We would not expect generators behind constrained areas to be disadvantaged in the market when compared to generators outside of constraint zones and vice versa' may be inconsistent, and this area of the guidance should be developed to address Ofgem's concerns in a more specific way.

It is a fundamental principle of well-functioning markets that participants are able to earn infra-marginal rent by earning the revenue of the marginal cost to meet the demand despite having a lower cost base. This principle encourages investments in efficiency and capacity, and results in market participants competing the marginal cost down to the most efficient level to be carried by the market. In the last three years, this has been a primary consideration in the delivery of new flexibility and merchant renewable investments.

This means that in any market, the expected profit for any given participant is the difference between their marginal cost to produce and that of the marginal unit needed to meet demand. In pay-as-bid markets such as the Balancing Mechanism, the expected pricing behaviour is for participants to attempt to price at the level of the expected marginal unit, whilst also undercutting other units pricing around this level.

However, the consultation document then goes on to say that a generator can only use more expensive energy Bid prices as a defence of constraint Bid pricing where that Bid price was reflective of the benefit the generator would have obtained absent the transmission constraint. As more expensive energy actions were taken (and therefore would also have been taken absent the constraint) it is always the case that the benefit the generator could have obtained in an unconstrained scenario is the same as or greater than the benefit they did obtain with the constraint in existence. This is because they could economically have priced up to the most expensive action that was taken, and earned infra-marginal rent.

The only exception in respect of a given settlement period is where the energy volume of the marginal Bid would not have been taken absent the constraint, and a less expensive unit would have been taken but couldn't because of the Bid volume up to the constraint. The efficient inframarginal rent to be earned in this scenario is up to the cost of the marginal unit dispatched in an unconstrained system with the same energy balancing needs. No generator has the information to calculate this, ex-post let alone ex-ante, as there is not enough detail on constraints to be gained from system tagging.

To the extent that prices less than the most expensive accepted energy instruction are almost always reflective of the benefit that an asset would have gained absent a particular constraint in that same period, we feel the guidance would benefit from being more specific about the particular circumstances that Ofgem are concerned could lead to an excessive benefit.

Separately, the guidance would benefit from a consideration of what wouldn't be considered a TCLC breach. Particular examples of cases where Ofgem wouldn't consider a price to be excessive (perhaps with reference to other levels in the market, to expand on the concept above) would be useful to de-risk market participant behaviour and aid more efficient price formation.

Unless targeted very precisely, regulations such as the TCLC can make it more difficult for any market participant to consider the question 'what is the energy cost' in a competitive market, and the more proscriptive a license condition (or the more proscriptively it is interpreted) the harder it is. This introduces challenges for price formation all along the curve, and increases the risk (and therefore cost) of investments and operations for energy companies.

Q4. Are there any examples of material costs or benefits of curtailment that are missing from Table 1?

Table 1 does not appear to take into account any consideration of long-run costs. Nor does it account for costs of contracts outside of the BM or restrictions in modes of operation (for example environmental limits and volume and service obligation around delivering heat to customers).

Regarding long-run costs in particular, a significant proportion of assets operate infrequently. This means that they have to recover long-run as well as short-run costs over a short period of time. Without the capability to price in long-run cost requirements in the BM, assets may become unviable.

Even for assets which operate more frequently, they may encounter a similar problem if they are subject to constraint Bids for a significant portion of time. If unable to include long-run

costs in an allowable Bid price, there is an increased probability that the TCLC forces these assets to Bid at a level which is effectively below actual cost.

There are other opportunities for assets to recover long run costs, including the wholesale market and the capacity market, and Offers in the BM. We appreciate that this consultation is separate from the consultation on options for the TCLC, however would like to flag that in the event the TCLC were to apply to other contracts (including BM Offers) without accounting for long-run costs in allowable costs, this would further reduce the opportunity for market participants to recover costs in the BM, which would in turn artificially suppress the price signals on which the wholesale market is based.

Q5. Are there circumstances which could objectively justify bid prices that would otherwise be excessive, which are not captured in the updated guidance?

See response to Q3 – a profit level up to that which would have been gained by the generator if they were priced at the most expensive action taken in the settlement period would necessarily have been objectively justified.

A number of assets in GB have unique cost profiles, for which there are no valid comparators. The guidance should account for this (for example units with customer service obligations, unique technologies and variable investment profiles).

Q6. Do respondents have any other comments on the proposed changes to the TCLC guidance?

We note that the consultation states that the updates to the guidance do not represent a change to the TCLC, however the TCLC is also explicitly interpreted in accordance with the guidance – therefore a change to the guidance is de-facto a change to the licence condition itself. We agree that the guidance should be regularly updated, but also that this process should be considered in the context of the full impacts it has on the industry's understanding of the licence condition and the subsequent impacts on the way that market participants make decisions and operate within the market.

We believe that the best outcomes for markets and consumers would be achieved by Ofgem operating on a principle of rapid engagement. By rapidly engaging with market participants that Ofgem deems to be either breaching or at risk of breaching TCLC, they can return to a compliant position sooner. This is in line with Ofgem's enforcement principles, but it would be helpful if the guidance established that Ofgem would seek to engage with potential breaches rapidly.