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Ian Marlee,
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11th May 2009

Dear Ian,

BWEA Response to 'Addressing market power concerns in the electricity wholesale sector'

Many thanks for the opportunity to respond to this consultation. BWEA does not feel that it is in a position to comment on the market power concerns raised. We have, however, provided some comments on some of the other issues raised and which are in any event relevant to discussions on the management of constraint costs. We welcome this opening out of the debate.

Demand-side response

BWEA is supportive of demand-side participation. We agree that smart metering, storage, etc, would improve the price-elasticity of demand in operational timescales. In longer-term contracting and billing timescales, demand might be able to respond to constraint costs if they were forecast and packaged into long-term access products.

BWEA would also note that some generators might similarly exhibit a "*vertical*" inelasticity to certain operational price signals. For instance, a variable generator such as a wind farm cannot fully flex its output in response to short-term constraint-related price signals, and obviously cannot respond at all to ex-post prices unless they exhibit some predictability. Generators will also differ in their ability to monitor and respond to complex signals on what the system might be like in each half hour.

Price spikes

It is quite difficult to unravel the rationale put forward in the consultation of when price spikes are and aren't providing a useful market signal. The consultation says that "*price spikes that are a consequence of underlying scarcity are a necessary feature of properly functioning markets and will encourage suppliers to contract in advance thereby sending appropriate signals for generation investment*" and that market power should be kept in check through competition, but that "*If price spikes due to market power are specific to a constrained location there is likely to be increased barriers to entry (since to respond to the price signal entry would have to be at the specific location) and no possible*

corresponding demand side response since prices faced by the demand side of the market do not currently incorporate a locational signal."

Price spikes in the BM could be indicating a scarcity of transmission capacity and it is difficult to unravel, from the information presented, under what circumstances Ofgem believes this is helpful. Ofgem also appears to be arguing against locational price signals in this consultation, but in other workstreams Ofgem is very much in favour of locational price signals.

Furthermore, Locational BSUoS, which is proposed as a response to high constraint costs, is a generation-only (i.e. there is no equivalent demand-side price signalling) locational price signal which is targeted at a certain group of generators behind a constraint. In this context the arguments set out in the consultation – which seem to be against locational price signals which can only be relieved by a locational generation-only response – are genuinely confusing and we would be very open to further clarification.

The salient point is perhaps that the BM does not provide overly useful long-term signals for building new transmission capacity to relieve its scarcity, or for providing new balancing services. In that respect we agree that if the price spikes in the BM are serving no purpose, there is of course a rationale for revisiting the design of the market and considering alternatives.

BWEA notes Ofgem's preliminary view that improving the link between constraint costs and the stimulation of new transmission capacity "*could be difficult given that investment on the transmission network is already underway and further opportunities may be limited*." BWEA would caution against being complacent on this. Whilst BWEA is very supportive of recent work on building and accelerating new transmission capacity, it is not clear to us that this is at the limit of what could be done at present. Again, it would be useful to understand the rationale and evidence for Ofgem's view on this.

BWEA does think that the rise in constraint costs, coupled with a drive towards connecting more renewables, have collectively focused minds on the need for and value of new transmission capacity. By the time constraint costs rise, however, it is arguably too late in the day to be signalling the need for new transmission capacity. Hence BWEA is supportive of much more forward-looking signals, including constraint cost forecasts.

SO and TO incentives

Measures to align TO and SO incentives would seem sensible where this is appropriate and assists in finding innovative ways of connecting projects, managing constraint costs and reinforcing the system.

BWEA agrees that there have been tensions between the SO and the TOs on constraint costs. It can be useful to have valid and different points of view aired, rather than being faced with a uniform company line which can be difficult to challenge without an alternative, informed, perspective. It can also be frustrating if underlying, misaligned incentives contribute to tensions which are hard to resolve.

Final comments

Finally, BWEA would like to take this opportunity to reiterate that it supports Ofgem in exploring a variety of options for managing constraint costs, and we will work hard in

finding some appropriate solutions. We would note that this is a complex area and it can be difficult to unravel the different factors at play. As far as possible it would help us and our members enormously if the language used has in mind a wide constituency of readers.

I hope you find these comments useful. If you would like to discuss any aspect of this response, please don't hesitate to contact me.

Yours sincerely,

Dr Gordon Edge, Director of Economics & Markets, BWEA