



CHEMICAL INDUSTRIES ASSOCIATION

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Addressing Market Power Concerns in the Electricity Wholesale Sector – Initial Policy Proposals

Response from Chemical Industries Association

The Chemical Industries Association¹ is pleased to have the opportunity to respond to this consultation. Following the *BERR Select Committee's Report On Energy Prices*² (BESC report) conducted last year and the subsequent Ofgem energy supply probe, we welcome that wholesale market interactions are now of focus.

However we still note that many of the conclusions from the above referenced BESC report still require a response from Ofgem (a recognition that was published in Ofgem's energy supply probe of last year). Not wishing to fully repeat CIA comments made to Ofgem in response to the energy supply probe³ (of which many of our concerns still remain) we strongly urge that these issues are urgently addressed with a dedicated action plan and timeline communicated as soon as possible.

Due to the nature of the consultation we are unable to give detailed responses to the questions posed, please find a number of general remarks below as our response.

General remarks

In the initial policy proposals Ofgem have raised concerns that the current electricity sector is venerable at times of system tightness, with constraint costs clearly rising over the last two years. We agree with Ofgem that these factors could have a detrimental impact on investment especially by new entrants who will not have the resources or systems in place to forecast or hedge positions. The CIA is therefore fully supportive of measures to ensure that there is a level playing field that ensures no barriers for new entrants. Any factors that can have knock-on effects on future liquidity and hence future wholesale electricity prices should be reduced. Generators and particularly smaller players are best placed to give more detailed responses to the questions posed especially in regards to possible license conditions. We would however like to note that if there is a suspicion that large generators are using their market dominance to play the market, that Ofgem must have the powers to investigate and penalise such behaviour. At a time in which the UK market requires substantial investment in new

¹ The CIA has in membership around 150 of the larger companies in the UK chemical and pharmaceutical industry, which has aggregate turnover in excess of £60bn and directly employs almost 200,000 highly skilled people. It is the only major manufacturing sector to generate a significant trade surplus.

² <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/1069/1069.pdf>

³ Sent to Ofgem by e-mail on the 1st December 2008



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infrastructure it is essential that new entrants are not unduly disadvantaged from market dominant players.

However we do believe there is a case at looking more widely at the generation market model. Market abuse is only possible on a serious scale when the fundamentals in the market - perceived lack of adequate capacity - allow and encourage it. As Dieter Helm⁴ has pointed out many times over the last few years¹, the conditions under which the present market model was set up have changed: we no longer have a surplus of generating capacity with assets needing to be "sweated", and we no longer have a surplus of cheap domestic gas for use in quickly and cheaply built gas fired plant. Requiring the construction of more gas storage would nevertheless help ease volatility in the gas market, and indirectly help reduce price volatility in the electricity market too.

Some of our members have the view that in regards to transmission it is worthwhile paying the small additional premium required to maintain a slight overcapacity. Market-based mechanisms for capacity investment may ensure there is "just enough" transmission capacity, however this allows generators to turn this to their own advantage. Industry prefers stable pricing structures and therefore encourages Ofgem to ensure investment in transmission infrastructure is more than adequate.

We note the current work Ofgem is undertaking with "*Project Discovery*" and look forward to the conclusions of the report in which we hope that there will be some clear visions of what is required to ensure a secure and competitive market in light of the significant challenges the must be overcome in the next 6 years. We need to ensure that the current regulatory regime is adequate to encourage generation new build that maintains an adequate safety margin, with a diverse primary energy base.

In the consultation document Ofgem note that they are not concerned with price spikes that are a consequence of underlying market conditions and that they are a necessary feature of properly functioning markets. The CIA would agree in rare times of extreme shortage, however the volatility and price spikes seen over the past several years have been frequent and damaging to large energy consumers. An example of which were the unprecedented high electricity prices last October (for that time of year) that were being driven by a predicted energy shortage that never happened (nor was going to happen). We would like to highlight comments made in the BESC report highlighting the damage of high price spikes and the subsequent damage caused by demand side response⁵. **Secure and competitively priced energy is essential.**

Please get in contact if you have any questions regarding our response. **We would like to hope that this consultation is the launch pad to further consultations on the wholesale markets.**

Yours sincerely,

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⁴ ¹ See for example his article in the Times: www.dieterhelm.co.uk/publications/Opinion_The_Times_160409.pdf, or even more recently this presentation: http://www.dieterhelm.co.uk/presentations/RUSI_290409.pdf, in particular slide 6 asking "What should be done?" which includes the key point that "Oversupply less serious than undersupply - tipping the balance towards greater capacity".

⁵ Page 12 / 13 of the BESC Final Report