

RWE npower's response to Ofgem's electricity wholesale market power concerns consultation

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RWE npower's response to Ofgem's consultation on wholesale market power issues

Introduction

The main focus of this response relates to Ofgem's proposals for a licence condition. It is a longstanding premise that market power per se is not an offence in competition law, only the abuse of market power. In terms of dominance under competition law, the OFT considers that an undertaking will not be dominant unless it has substantial market power. This reply therefore relates to Ofgem's proposals to introduce a market power licence condition (MPLC). As the consultation document notes, Ofgem has tried previously to introduce a market abuse licence condition (MALC), but was over-ruled by the Competition Commission.

Ofgem has a statutory duty to have regard to best regulatory practice (Section 4AA of the Gas Act 1986 and section 3A of the Electricity Act 1989): regulatory activities should be, amongst other things, proportionate and only targeted at cases in which action is needed.

Ofgem identifies the following issues with the current market arrangements in relation to the exercise of market power:

- I. Constraints which may confer the ability to exploit market power. Ofgem identifies three variants of this issue:
 - a. Problems arising from existing constraints (Paragraphs 1.1, 1.6, 1.9, 1.11, 6.1)
 - b. Problems arising in the future from constraints which arise as a result of outages connected with system reinforcements (Paragraph 1.15)
 - c. Problems arising from the connection of renewable generation in Scotland.(Paragraphs 1.29, 1.30)
- II. Pricing at times of system tightness. (Paragraphs 1.2, 4.2, 6.1)
- III. Ancillary services markets (Paragraphs 1.2, 1.7)
- IV. Experience in Overseas markets (Paragraph 1.35)

Ofgem asserts that existing powers are not adequate for dealing with the issues (Paragraphs 1.10, 6.7). It is vital that there is a convincing evidence base to justify the accretion of new powers. We therefore examine each of Ofgem's issues in turn using the assessment framework set out below.

In respect of any proposal, we believe it is incumbent upon Ofgem to demonstrate that:

- a. There is, or is likely to be, a material issue associated with market power;
- b. Existing powers are not adequate for dealing with the issue;
- c. The proposed remedy is the least intrusive method of dealing with the issue;
- d. The remedy does not create more problems than it solves; and

- e. The issue is significantly different from those which Ofgem put up during its first attempt to introduce a MALC.

In determining the answers to these five questions, the burden of proof is on Ofgem. We use these questions to assess the merits of Ofgem's proposals.

Paragraph 4.6 of the consultation document expresses a clear preference for "sufficient powers to tackle a wide range of market power issues on an ongoing basis, including problems that may not have been envisaged at the time the licence condition was introduced." We believe that such a conclusion is premature and that a blanket approach designed to tackle as yet unforeseen spectres conflicts with best regulatory practice raising the prospect of the misuse of regulatory power. As a competent regulator, Ofgem will be able to identify genuine issues on the horizon and make a timely case for measures that can address them. Furthermore, it appears to us that Ofgem may be overstating the risks to consumers which justify its preferred approach.

Issues perceived by Ofgem

Constraints

Is there or is there likely to be a material issue?

Concerns regarding constraints are overwhelmingly the most important issue associated with market power based on the information provided in Ofgem's consultation. The paper notes (Paragraph 1.14) that constraint costs are projected to rise from £84m in 2005/2006 to £238m in 2008/09 with a further rise in the current and future financial years.

Table 1 shows too that constraint costs arising from Scottish actions constitute the overwhelming bulk of total constraint costs, nearly 90% in 2008/09. It is clear that the root cause of these costs is the decision by government and Ofgem to implement BETTA. This assumed that the Scottish and England & Wales markets could be combined. It is not clear what analysis the government and Ofgem conducted at the time to assess the impact of this decision on constraint costs or what motivated the decision. However, Ofgem's present analysis implies that the effect has been to confer major benefits on Scottish generators at the expense of customers in England and Wales.

It is notable that proposals to allow the connection of renewable generators in Scotland before reinforcements have been effected to the Scotland/England transmission infrastructure and other transmission lines inside Scotland would have the effect of exacerbating the problem still further (See Paragraph 1.27 on connect and manage). Indeed this risk is recognized by Ofgem in Paragraph 1.29. Such decisions should not be taken lightly in view of Ofgem's various statutory duties to protect consumers and to ensure an efficient system. At the very least, it would be necessary to show that the shadow price of carbon saved through connect and manage exceeds the additional cost in terms of ROCs, reinforcement and constraint costs. There is a significant risk of environmental objectives colliding with the affordability objective

and care must be exercised to ensure that the overall policy response is coherent. We note that Ofgem is mindful of this conundrum.

At Paragraph 1.16 Ofgem expresses concern that “the exploitation of market power was to have the effect of deterring new entrants and reducing the competitiveness of the market”. This proposition is at odds with the way we know markets work. Contrary to Ofgem’s proposition, if an incumbent has market power and is able to charge higher prices, this will encourage new entry or substitutes such as new transmission build. Indeed given the queue for new connections in Scotland there does not appear to be any evidence that locational market power has in any way restricted new entry (rather it is the lack of transmission capacity that is the major “constraint” on new build, an issue being addressed through the Transmission Access Review).

That existing powers are not adequate for dealing with the issue

There is a concern that Ofgem may have overstated the difficulties in applying the Competition Act 1998 (CA98). Paragraph 1.35 cites difficulties in applying the CA98 where market power is intermittent in nature and/or held by more than one generator. Ofgem asserts that this renders the task of establishing dominance or collective dominance problematic.

First, there is a real danger that Ofgem confuses normal market responses to intermittent market tightness (i.e. high prices to clear the market) with market abuse. If demand outstrips supply, producers can be expected to charge more than their variable costs. This is how they cover their capital costs; in no way does this indicate market abuse.

Second, Ofgem simply asserts that there is a problem in applying the standard toolkit of competition law. No supporting evidence is adduced. For example:

- I. Ofgem does not demonstrate that the technique of the SSNIP test cannot be applied to define an appropriate market;
- II. Ofgem does not demonstrate that the SSNIP test and other techniques cannot be applied to evaluate whether there is dominance or collective dominance.

Third, as a general principle, we should avoid bespoke competition law provisions for particular industries. There is a danger that Ofgem overstates the uniqueness of the electricity market. There are at least a number of other activities where the market is intermittently tight, such as airports, railways, motorways, flowers (on Valentines and Mothers Day) and pubs (which charge for entry on Christmas and New Year’s Eve) and family vacations taken in the school holidays. There is no suggestion that these markets need special, more intrusive competition laws.

It is notable that if techniques of competition economics are properly applied that they may well conclude that Scotland is a separate geographic market. If so, Paragraph 3.6 of Ofgem’s consultation notes that the HHI of the main generators in Scotland indicates a high degree of concentration. So, contrary to Ofgem’s claim, it does appear that Ofgem’s concerns could be tractable to existing competition law and economic tests. For similar reasons, Ofgem’s statement at Paragraph 3.7 is doubtful: “In Scotland...low market concentration...could still lead to times of significant market power.” If care is taken to properly identify the relevant market,

one will normally find high concentration if there is indeed high market power. It is important to carefully identify the problem in order to specify the most appropriate remedy.

As regards the issue of the “pivotal generator” we note that the Competition Commission’s evaluation of some of its past cases (January 2008) concludes: “European and other competition policy has increasingly moved away from rigid adherence to form-based measures of concentration, to an ‘effects-based’ assessment of abuse...In the UK, the OFT’s guidelines on assessment of market power state clearly that there are no market share thresholds for assessing dominance.” The Competition Commission concludes that the existing competition law provisions are likely to have traction over pivotal generator type cases. Ofgem itself (in Paragraph 4.5) acknowledges the tool of pivotal analysis.

Similarly, Ofgem claims that it is harder to apply the CA98 to excessive pricing than to exclusionary practices. Ofgem adduces no evidence in favour of this assertion. But if it is true, it plainly is an issue which is not unique to electricity.

The conclusion is that:

- I. Ofgem has not provided any evidence to back its claims of deficiencies in competition law;
- II. If there are deficiencies, they are potentially generic and should be addressed as such;
- III. It is important to have a rigorous framework through which to assess the abuse of a dominant position so that normal market responses are not deterred. The CA98 provides such a framework; and
- IV. An exceptionally compelling evidence based case must be made in order to justify sector specific, discretionary powers. Ofgem has not made this case.

As Ofgem explains, it is already actively applying measures which are currently available in terms of:

- NG’s response to its open letter proposing a locational element to BSUoS charging and administered prices for inter-trip contracts
- Changes to cash-out prices through Modification P217 to be implemented in November (which Ofgem claims should prevent the circumstances of Sept/Oct 2007 from re-occurring)
- The Transmission Access Review which Ofgem claims, depending on the options taken, could provide better signals for more targeted and efficient investment which might alleviate constraint-related problems (as well as new generation reducing market concentration).

As it goes on to state that these measures will not fully address its concerns, Ofgem needs to explain precisely what the regulatory gaps are and where the remaining gaps will be.

Ofgem also refers to improved mechanisms to align SO and TO incentives. As we have commented in previous responses to SO Incentives consultations, an incentive framework is

required which incentivizes the minimization of the combined costs of transmission maintenance, investment and constraints.

That the proposed remedy is the least intrusive method of dealing with the issue

Constrained off generation

We suspect that the application of the analytical framework of the CA98 would lead to the conclusion that the assumption that Scotland could be linked to England in one seamless market in all circumstances was poorly thought through and is seriously flawed. Where constraint costs are small in relation to the total market, the simplifying assumption of a single market is an acceptable approximation. However, where this is not the case, the appropriate response is to recognize the physical reality through market decoupling where there are derogated non-compliant transmission boundaries since the associated transmission assets are not compliant with the GB Security and Quality of Supply Standard (GBSQSS). This is the approach taken in the Nordic markets. Another way of putting this is to say that the geographic scope of the market should be defined to properly reflect the physical realities. In electricity, this necessarily involves an analysis of the robustness of the transmission infrastructure linking different parts of the network.

In our view, the Scottish market decoupling remedy for the duration of the derogation of the transmission boundary from the GBSQSS is the most effective solution to the artificial market power which the present arrangements confer on Scottish generators. It is the solution which is most consistent with Ofgem's better regulation statutory duties and the one which best reflects correct market prices, conferring the right incentives on market participants. It directly incentivizes Scottish generators to invest in reinforcements to the transmission system. The solution has the added advantage that England & Wales consumers are not paying for Scottish constrained off plant whether or not the charges are excessive.

Once the reality that Scotland is, at least at times, a separate market is recognized the full range of alternative remedies to the locational power in the relevant market deserve proper consideration before a premature conclusion is reached in favour of the MPLC. Clearly a MALC or MPLC is not universally perceived as the only or the most appropriate remedy. For example, as Ofgem notes itself, its predecessor concluded that divestment by National Power and Powergen was the appropriate remedy to perceived market power issues in the England and Wales market.

In its 2000 report, the Competition Commission concluded that there may be a case for a MALC, but only if manipulation cannot be satisfactorily dealt with by a rule modification. Clearly, appropriate rule modifications and consequential changes can deal with the perceived problems.

Constrained on generation

At Paragraphs 1.4 and 1.6 Ofgem suggests that the alleviation of "market power would require generation at a specific location". The implication is that a MALC is necessary to address this. In fact, the proposition is flawed on a number of levels:

- First, it is rarely, if ever, the case that generation is required at a specific location to resolve congestion across a non-compliant derogated transmission boundary. A constrained zone will usually cover a substantial geographic area and generation anywhere within the zone will alleviate the need to constrain a particular plant.
- Second, if it is indeed the case that generation is required at a specific location, then the existing competition law doctrine of the “Essential Facility” can be called into play. This would ensure that the existing power station made the necessary facilities available to the new entrant on fair terms. To do otherwise is deemed an exclusionary practice and abuse of a dominant position under existing law.
- Third, the proposition ignores the fact that transmission system reinforcement is a substitute for more zonal generation and is available to address any market power concerns. Paragraph 4.2 also ignores the impact of transmission reinforcement as an alternative to new entry in constraining market power.

That the remedy does not create more problems than it solves

The breadth of the discretion which Ofgem desires raises substantial uncertainty compared to the current regime, a concern acknowledged by the Competition Commission.

The issue is significantly different from those which Ofgem put up during its first attempt to introduce a MALC.

Whilst Ofgem has demonstrated that the costs of Scottish constraints have increased significantly in recent years and that Scottish bids and offers have diverged from those in England & Wales, Ofgem has not demonstrated that the appropriate course of action is to impose a MALC. Neither the increase in the cost of constraints nor the divergence of Scottish bids and offers is sufficient to merit a conclusion that there is a market power issue. And Ofgem presents no more conclusive evidence. There are a number of possible explanations for the increase which have nothing to do with the exploitation of market power. Relevant questions include:

- To what extent is the increase in costs due to the increase in the volume of constraints?
- To what extent is the increase in costs due to the increase in the unit cost of resolving constraints which one would expect as greater demands are made to constrain plant on and off?
- To what extent is the increase in costs due to the marked rise in primary fuel costs in 2008?
- To what extent is the increase in costs due to the exceptional outage circumstances prevailing in 2008? For example, the pressure to fit FGD to coal fired power stations.
- To what extent might the increase in costs be due to new environmental rules impacting on economic running regimes e.g. the 20,000 hours rule for opted out plant and the plant equals stack LCPD rule?

- vi) To what extent is the increase in costs due to sub-optimal regulatory arrangements whereby distinct incentives apply to transmission ownership and operation?
- vii) How quickly will the constraints be relaxed by transmission reinforcements?
- viii) How will the position be affected by other developments such as power station openings or closures?
- ix) To what extent is the increase in costs due to moving transmission or generation outages?

Far more needs to be understood about the nature of the issue before worthwhile conclusions can be drawn about the effectiveness of different remedial tools.

Conclusion on Constraints

We recognize that there is a material issue on rising constraint costs but do not find that Ofgem has made the case for discretionary powers, having still to fully consider the issues, apply the rigour of the CA98 framework and to see the effect of the measures it is already undertaking. In line with the Competition Commission's previous advocacy of appropriate rule changes in preference to the imposition of MALC, Scottish market decoupling for the duration of the derogation of the transmission boundary from the GBSQSS would seem to be the most effective remedy to any market power conferred on the Scottish generators by the present arrangements.

Pricing at times of system tightness

Is there or is there likely to be a material issue?

In Paragraphs 1.5 and 1.7, Ofgem states that it is not concerned about price spikes which are a consequence of underlying market conditions. Indeed, Ofgem notes that these are a necessary feature of properly functioning markets, playing an important role in delivering security of supply.

Ofgem cites no specific examples of existing concerns, but speculates regarding hypothetical situations in which price spikes might not be justified by general market conditions. The cases cited are where, under current arrangements, suppliers do not see the prices directly, namely where high prices arise as a result of constraints and prices for services ancillary to the half hourly energy market such as real time system balancing. The first case (constraints) is considered above.

As regards ancillary services, Ofgem cites no present examples of concern. Ofgem's claim is that the vulnerability to undue exploitation of market power is likely to increase due to a significant increase in new renewable generation connecting to the system. A significant increase in renewable generation connecting to the system would increase the requirement for reserve. However, there are many steps between this conclusion and a conclusion that there is a concern about the exercise of market power. Relevant questions include:

- i) How much intermittent renewables will connect, what type will it be, when and where will it be located?
- ii) How does the answer to (i) translate into a need for increased reserve? The relationship will not be linear. On the one hand, existing low merit plant will be available for a number of years yet. On the other hand, as the amount of intermittent plant increases, portfolio effects would be expected to attenuate intermittency risks; any marked increase in reserve requirements is likely to be many years away.
- iii) What will be the state of competition in the reserve market?
- iv) What substitutes for reserve may exist, for example demand side response, storage?

In addition, Ofgem appears to have some concerns regarding circumstances when the general half hourly market is tight: Paragraph 4.2 states “market power can be intermittent or transient in nature, but nonetheless very costly to consumers in certain periods, while also being very difficult to erode over time through new entry”. Ofgem has adduced no evidence of actual abuse at times of tightness in the half hour market nor has it identified any reasons to suppose that the issue will become material in the future.

Lastly, at Paragraph 1.9 Ofgem cites “environmental legislation limiting the use of certain types of generation capacity” and at Paragraph 1.35 leading “to greater uncertainty when generation may be run” as potentially conferring market power. Ofgem provides no explanation as to how this could result in market power. If the concern is simply that less capacity will be available to the market, Ofgem does not explain why this is to be distinguished from any other outage or period of tight market conditions during which one would expect prices to rise to equilibrate supply and demand (see Paragraph 1.5 where Ofgem acknowledges this). Furthermore, given restricted hours under LCPD, it is more likely that coal plant will run during tight market conditions when prices are high.

That existing powers are not adequate for dealing with the issue

Our comments set out under the constraints “existing powers” section apply equally here: it is not at all clear that existing competition law powers are not adequate or appropriate to deal with this type of concern. Paragraph 6.4 asserts that “there may be times when low market concentration could still lead to times of significant market power.” But it would be erroneous to conclude that such circumstances are out of scope of existing competition law provisions. It illustrates the dangers of Ofgem taking broadly based powers which enable it to avoid undertaking rigorous analysis to reach robust conclusions. Essentially, the proper questions would seem to be:

- I. Whether peak half hours are a separate market to off peak half hours. It is difficult to see why the SSNIP test could not be used to resolve this question
- II. What the geographic scope of the market is. Again the SSNIP test comes in to play.
- III. If so, whether dominance or collective dominance exists. A priori, it is difficult to see why the techniques of industrial economics cannot be brought to bear on this question.

Again, the SSNIP test has no market share requirements for determining dominance, only that the party can sustain a small but significant non-transitory increase in prices above the competitive level. So, if the pivotal player can sustain an elevated price, say because of entry delays, then the CA98 has leverage.

If Ofgem asked itself these questions it is almost impossible to see how it could conclude that existing competition law and economic techniques and powers are deficient. The conclusion is that Ofgem has not made the case that new powers are necessary for resolving the potential issues of general market dominance in the half-hourly market.

Leading competition authorities emphasize that it is important to pursue cases where the outcome is not guaranteed in order to flesh out the boundaries of competition law. We would urge Ofgem to have the courage to follow this route, rather than to try to circumvent the competition law requirement to reach robust conclusions through rigorous analysis.

That the proposed remedy is the least intrusive method of dealing with the issue

Existing competition law powers impose a discipline to prove whether there is a real issue, and if so, what it is. It follows that they are better suited to accurately identify the most appropriate remedy than a loosely worded MALC.

In Paragraph 1.10, Ofgem expresses concerns about the impact of large price spikes as a barrier to new entry. However, to the extent that price spikes in the cash out prices are due to non-energy market factors, action is already under way to address the issue, by stripping non-energy actions out of the calculation of balancing prices through implementation of modification proposal P217 in November 2009.

That the remedy does not create more problems than it solves

On the other hand, there are real dangers that an additional power would create serious problems. Ofgem has acknowledged that price spikes are necessary when the system is under stress. In addition, the Competition Commission has identified a number of MALC risks including that Ofgem may take action when market responses are those one would expect in times of stress. The risks associated with action by Ofgem are now more acute than when the Competition Commission first identified the potential. Why? Because the cost of energy has become more of an issue for consumers generally. And because Ofgem is now under severe pressure from a range of stakeholders to be seen to be taking action to protect the interest of those consumers.

Second, the Competition Commission identified the risk that companies may themselves depart from competitive pricing strategies for fear of falling foul of the MALC. At Paragraph 4.4, Ofgem emphasizes that it would “be important to make clear that generators who respond to overall scarcity would not be subject to such enforcement action.” Against this, Ofgem’s proposed guidelines for when a generator is deemed to have market power (set out in Paragraph 4.5) are precisely those circumstances when the market is tight. Note also that scarcity conditions can occur intermittently. In such circumstances, competitive generators would be expected to price at Short Run Marginal Cost (SRMC), namely the opportunity cost of their customers. In its discussion of the preferred benchmark for assessing abuse, Ofgem

suggests using cost plus or LRMC rather SRMC. Ofgem's presumption seems to be that cost plus or LRMC would allow generators more revenue than SRMC. But it appears that Ofgem is confusing SRMC with short run variable operating cost. As noted above, when demand outstrips supply, SRMC is the opportunity cost of customers and may significantly exceed LRMC.

The conclusion is that Ofgem's own consultation is confused as to whether pricing at SRMC, as properly understood, would be construed as undue exploitation of market power. It would not be surprising therefore if generators distorted their own pricing in response to such a condition, leading to a form of the "missing money" problem acknowledged by Ofgem. The existence of this condition under-remunerates generators, creating a disincentive to investment which, ultimately, exacerbates the tightness of the market.

On the basis that licensees are innocent until proven guilty, the general conclusion is that the risk of an Ofgem type I error (identifying abuse where none exists) is serious both in terms of probability and impact for market participants and for customers.

In addition, the imposition of a MALC is likely to stymie other market responses by eroding the incentive to invest in imaginative demand side energy efficiency and energy demand time shifting measures.

The issue is significantly different from those which Ofgem put up during its first attempt to introduce a MALC.

This issue is essentially the same as the one considered and rejected by the CC. Ofgem has adduced no evidence to suggest that the CC would need to revise its verdict.

Conclusion on Pricing at times of system tightness

Ofgem merely speculates regarding hypothetical situations in which price spikes may not be justified by general market conditions. Its concerns about price spikes being a barrier to new entry are already being addressed and those on the impact of environmental legislation are poorly articulated. As the confusion on the ability to price at SRMC indicates the imposition of a MALC is likely to lead to under-remunerating generators and so to disincentives to invest in the market. Therefore, it is incumbent on Ofgem to pursue competition law cases and to develop competition law in practice.

Ancillary services

Is there or is there likely to be a material issue?

As discussed above, as regards ancillary services, Ofgem cites no present examples of concern. Ofgem's claim is that the vulnerability to undue exploitation of market power is likely to increase due to a significant increase in new renewable generation connecting to the system. A significant increase in renewable generation connecting to the system would increase the requirement for reserve. However, there are many steps between this conclusion and a

conclusion that there is a concern about the exercise of market power. Relevant questions include:

- i) How much intermittent renewables will connect, what type will it be, when and where will it be located?
- ii) How does the answer to (i) translate into a need for increased reserve? The relationship will not be linear. On the one hand, existing low merit plant will be available for a number of years yet. On the other hand, as the amount of intermittent plant increases, portfolio effects would be expected to attenuate intermittency risks; any marked increase in reserve requirements is likely to be many years away.
- iii) What will be the state of competition in the reserve market?
- iv) What substitutes for reserve may exist, for example demand side response, storage?

That existing powers are not adequate for dealing with the issue

Ofgem makes an implicit and unsubstantiated assertion that because end consumers do not directly demand or respond to ancillary services (which contribute to the quality of supply), existing competition law is ineffective. But Ofgem provides no evidence that this is the case.

On the contrary, it would seem relatively straightforward to use competition law techniques such as the SSNIP test to identify specific ancillary services markets and whether market power exists in those markets. Moreover, there is a demand side in the form of NGC with incentives to keep ancillary services costs in check.

That the proposed remedy is the least intrusive method of dealing with the issue

It is self evident that a broadly based market abuse power has wider scope than is necessary to address any perceived problems in ancillary services.

That the remedy does not create more problems than it solves

A corollary is that the uncertainty associated with a broadly based licence condition is likely to outweigh the benefits in the ancillary services markets. It must be borne in mind that the ancillary services markets are relatively small and have NG as the monopsony buyer. This might in itself be expected to attenuate any potential for a generator to exploit unduly. The claim in Paragraph 1.7 that market power is unlikely to be kept in check through competition is specious as NG is well placed to encourage competition for ancillary services and has every incentive to do so.

In Paragraph 1.10, Ofgem cites the adverse impact of price spikes on the competitive position of smaller players as one reason for concern. However, Ofgem itself acknowledges (Paragraph 1.7) that suppliers do not contract for ancillary services, so this justification for intervention does not apply to ancillary services.

The issue is significantly different from those which Ofgem put up during its first attempt to introduce a MALC.

Ofgem has adduced no evidence that current or prospective concerns regarding the ancillary services market are more serious than when the CC rejected MALC.

In fact, the ancillary services market is now more competitive than it was when the last MALC was proposed. More players are now involved in the various markets, including to a greater degree, the demand side. NGET has gradually opened the various markets to competitive processes since the introduction of NETA/BETTA, for example, frequency response, short term operating reserve and warming contracts.

Conclusion on ancillary services

The claim that there may be market power concerns in the ancillary services markets is highly speculative and unsubstantiated. First sight indications are that existing competition law powers would be fit for purpose, should any issues ultimately materialize.

Experience in Overseas Markets

In Paragraph 1.35, Ofgem cites overseas developments as justifying intervention in the UK. This argument falls at the first hurdle as the first condition for evaluating whether a MALC is required in the UK is whether there is an actual or credible potential issue **in the UK**. Overseas developments are irrelevant. In fact, every study which has been carried out has found the GB market to be highly competitive. Moreover, the fact that overseas jurisdictions have given themselves powers to intervene in their energy markets is far from compelling, as a casual look at the impact of those interventions shows; Ofgem's own consultation identifies the "missing money" problem caused by intervention in many overseas markets.

Overall conclusion

Ofgem seeks to award itself sweeping new powers. This is understandable; it is also misguided. Ofgem's preferred option is equivalent to equipping yourself with a chain saw and persuading yourself you can use it with the precision of a scalpel. You can't. There is a real danger of bringing the whole tree crashing to the ground. A broad power for regulatory intervention would simply compound the uncertainty which already exists arising from prospective environmental regulations. Better to ask yourself: do I need any more tools at all and, if so, what do I need for the job in hand?

This response has reviewed the issues raised by Ofgem and shows that Ofgem's real concerns focus on constraints on the Scotland/England derogated non-compliant transmission boundary. It suggests that a proportionate and targeted response would tackle the issue directly by:

- I. Recognizing that Scotland is a separate geographic market
- II. Taking steps to address market power concerns in that market
- III. Avoiding actions which will exacerbate market power in Scotland.

There are no other issues which warrant the kind of licence condition intervention proposed by Ofgem. In particular, the proposal at Paragraph 4.6 to introduce a condition with broad scope to catch as yet unidentified problems fails the proportionate and targeting elements of Ofgem's best regulatory practice statutory duty. Ofgem, in its market monitoring role, should receive ample warning of any problems before they bite. Speculative regulatory intervention at this stage would be premature and undermine market developments which would otherwise provide self-correcting forces.

Furthermore, leading competition authorities emphasize that it is important to pursue cases where the outcome is not guaranteed in order to flesh out the boundaries of competition law. We would urge Ofgem to have the courage to follow this route, rather than to try to circumvent the competition law requirement to reach robust conclusions through rigorous analysis.