

Ben Woodside  
Ofgem  
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8 May 2009

Dear Mr Woodside

## **Market Power Concerns in the Electricity Wholesale Sector**

### **Introduction**

Welsh Power Group Limited welcomes the opportunity to respond to this consultation document. We considered ourselves to be a smaller player, though active in a number of markets. We are the owners and operator of Uskmouth Power, a 363MW coal fired power plant in South Wales, and thus the holder of a generation licence and directly impacted by Ofgem's proposals.

Welsh Power shares Ofgem's concerns about market and power and the ability of larger, portfolio players, to impact prices to the detriment of customers, as well as other market players. We were disappointed that Ofgem did not try to pursue their investigation into SSE and SP via a Competition Commission referral to test their assertion that the Competition Act cannot deal with locational, temporal and multi-party market power. We believe that such a referral would have flushed out issues of asset ownership and offered the market and Ofgem a steer on exactly what could go in licences that can address the specific potential for market abuse if not captured in the Act.

### **Wider Context and Market Solutions**

Welsh Power believes that there are currently a significant number of potential market changes that would appear to address some of the concerns that Ofgem raises. It would seem prudent for Ofgem to see if these market changes can address the problems identified, before increasing regulatory risk in a market where

new investment is desperately required to achieve a step change in generation technology against a background of significant financing hurdles.

We do not feel the incentive arrangements of the TO and SO are very significant in relation to the problems identified, in fact we are generally concerned that there are too many incentives and not enough direct regulation of monopolies. We would rather reduce the incentives and urge the TOs and SO to work together to minimise system costs and disruptions. This would clearly be easier if there was simply one GB TO or the TO's in Scotland were subject to full ownership unbundling. We would support a move to full ownership unbundling of all TOs as this is the most efficient way to ensure regulation is effective and all system users are treated equitably.

Welsh Power recognise that proposals, if/when implemented, like locational BSUoS, CAP 170, P217, Alternative CAP 164, etc. are all likely to have an impact on incentives faced by generators behind constraints. We believe that allowing some, or all, of these changes to take place before licence changes would again allow a better understanding of where any issues remain that Ofgem believes need to be addressed. We would note that market changes that were well worked up, such as CAP 164, are better than the interim approach put forward by Ofgem. The issue being that changes implemented quickly and without full consideration are likely to have unforeseen consequences.

Welsh Power has argued for divestment of plant in the past and we continue to believe that the integrated players should be forced to sell 100% of their output to unrelated parties, if they are not made to divest physical plant. This is because the market design confers a benefit onto integrated players that cannot be addressed by divestment alone. We agree with Ofgem that "virtual" divestment is unlikely to be effective and will simply create further problems for Ofgem in regulating the market. However, we are unconvinced that the problems identified can be addressed in a timely manner by divestment, though we do believe that Ofgem should consider wider structural solutions to improve the level of competition across the market as a whole.

#### **Specific Measures on Generators**

Welsh Power is not convinced that Ofgem has made a robust case that the Competition Act 1998 could not be used and feel it is unfortunate that Ofgem did not take SSE and SP to the Competition Commission (CC) in order to test the law before ruling it out as an effective enforcement tool. While we can see that the case would

be difficult, we also believe Ofgem may have got considerable support in making their case to the CC. As it is, we believe that if Ofgem try to force licence changes on generators another CC referral is highly likely.

Welsh Power do not object to changes to licence conditions per se, but in this case we will want to see the detailed proposals before we can support Ofgem's proposals. As a matter of principle we believe that such conditions should only apply to larger companies and not to small independents such as ourselves who cannot have market power with one 363MW plant. We believe we must be able to charge for our product what the market will bear, including being able to put prices up at times of system stress when market conditions increase power prices, even on a locational basis. We should not face disproportionate regulatory risks from onerous licence conditions as such risks will further deter new entrants from an already concentrate market.

Welsh Power would like to see not only the wording of the licence condition, but also the guidance notes that Ofgem indicate that they will also publish. Without guidance, produced via a process of consultation, the condition will represent significant regulatory risk. We suspect the Ofgem will find it extremely difficult to draft guidance that will add enough clarity to reduce regulatory risk to the degree that the market will want, but we are happy to discuss the principles further.

Welsh Power do not support the idea of ex-ante regulation. It is not acceptable in a "competitive market" for the regulator to set the price of power, either directly or indirectly. Attempts at calculating the average costs of generation will be arbitrary and result in debates between generators and Ofgem about who buys what fuels for where, etc.. Such proposals would add a degree of micromanagement that is likely to increase the risks of regulatory capture or worsen relationships between regulated and regulator. While Ofgem may find its job easier if there are mechanistic rules we believe that such rules will always be open to interpretation and will undoubtedly not be flexible enough in every circumstance. Overall such micromanagement will raise regulatory risks to unacceptable levels and deter investment.

### **Implementation**

Welsh Power would prefer to see a sectoral reference to the CC to allow consideration of the wider market structure. We remain concerned by the beneficial position afforded to the integrated players and feel that the CC offers the best route to deal with structural issues. If Ofgem instead pursue a licence modification it seems probable that such a proposal will end up at the CC. A broader sectoral

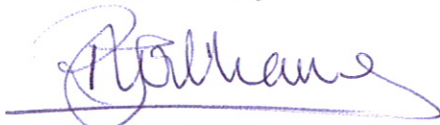
referral may offer a better longer term solution than a narrow licence condition referral.

If Ofgem go for the licence route, we are also of the opinion that by the time implementation occurs much of the transmission work should at least be nearing completion. This may therefore make the condition appear to be unnecessary or require that Ofgem word such a condition to be as flexible as possible. Ofgem must consider if the routes for increased regulation can be made to be "future proof" or be implemented in a timely manner.

We are unclear why Ofgem suggests that Primary Legislation may be needed to create a system for appeals. We would assume that if there was a licence condition and Ofgem took action for breach of licence, that the generator could appeal any adverse decisions to the CC in the same way other competition issues can be appealed. Welsh Power would urge Ofgem not to implement any changes that increase regulation without ensuring that there are appropriate appeals processes to act as a check and balance for both the regulated and the regulator.

I hope that you find these comments helpful. If you have any questions or wish to discuss any of the issues raised in this letter please do not hesitate to contact me on 020 7659 6620 or Lisa Waters 020 8286 8677.

Yours sincerely



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