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Dear Sir,

**Consultation response to “Wholesale power market liquidity: final proposals for a “Secure and Promote” licence condition”**

We welcome the opportunity to respond to Ofgem’s consultation on its final proposals for interventions to enhance liquidity in the GB power market. As Carlton Power is not a supply company and does not have a direct interest in the supply market, we will limit our responses to comments concerning liquidity in the wholesale market generally and the detailed design of the proposed market making obligation.

It is our view that a well-functioning retail market which provides value for money to consumers presupposes and requires a competitive wholesale market and hence a structurally sound generation sector. It is therefore our opinion that Ofgem should see liquidity, competition and the creation of an effective wholesale market as goals in themselves. Such a wholesale market will reduce barriers to entry into generation as well as lead to a better functioning retail market.

In its Gas Generation Strategy of December 2012, DECC concluded that “*we are likely to need significant investment in new gas plant.*” In Chapter 3 it identified three key issues for enabling this required investment in gas plant. One of these was the need to take steps to improve wholesale market liquidity and in this regard it placed significant importance upon the success of the Secure and Promote proposals. As DECC further recognized in paragraph 3.59 of its Gas Strategy “*Independent generators require a route to market for their power and need to be able to sell their power ahead of delivery to hedge their price risk.*” We agree with this assessment.

As an experienced developer of new power generation and particularly efficient large combined cycle gas turbine projects, Carlton Power has been in discussion since early 2012 with a number of companies that are monitoring the current reforms within the UK electricity industry and are potential new entrants to the gas fired generation market. Many of these organisations are based overseas and they each essentially require confirmation of the same two things before investing in the UK:

- a degree of revenue certainty (that will potentially be met by the Capacity Market reforms within EMR) to compensate for the fact that plant will not run at baseload and they face uncertainty over future running hours due to large scale renewable development; and
- a functioning, transparent and reliable route to market for the sale of the power generated. The effectiveness of Ofgem's proposed wholesale electricity market liquidity reforms is therefore crucial to the realisation of any ambition to secure new independent gas plant.

We welcome Ofgem's work to improve wholesale electricity market liquidity and in our submission to an earlier consultation broadly supported the proposal for mandatory auctions provided this was designed properly to improve liquidity, transparency and competitiveness in the UK wholesale market. Whilst we are disappointed by Ofgem's decision not to adopt mandatory auctions, we believe there is potential value in the market maker proposals, but again on the basis that the detailed design of the market making obligation will similarly improve liquidity, transparency and competitiveness. There are a number of key issues in relation to the market maker proposals which are likely to be the subject of discussion and which will be key to determining whether the proposals meet these goals. We now deal with these in turn below.

### **Range of Products**

New entrants and independent generators would like to see the mix of products include longer range products than those included in Ofgem's current proposals. As a compromise Ofgem's current proposed list of products is potentially workable but it would be a significant retrograde step if Ofgem were to agree to pressure from potential market-makers to limit the range of products to the shorter range products or even to defer the implementation of the long range product element of the proposals.

### **Bid-offer spread limit**

The underlying principle of Ofgem's market-maker proposal is to establish genuine pricing by obliging market-makers to post what will be essentially a single price at which market makers would be prepared to either buy or sell electricity. The purpose of a bid offer spread should be to deal with inevitable dealing and exchange costs but otherwise provide one price at which the relevant party would be prepared either to buy or sell. The spreads should be kept very narrow to ensure the most accurate pricing and to avoid gaming. The wider the spread, and particularly if (as some potential market-makers are arguing) there is no regulated spread and market-makers can name buy and sell prices as widely spread as they wish, the more scope there will be for a market-maker to decide whether it wishes to buy or sell and post a realistic price for the transaction it wishes to see and a less realistic price for the transaction it does not want. This will negate the underlying principle of the proposed market-maker regime and not establish real pricing.

### **Availability**

We do not support the restriction of the availability requirement to 50% over the course of a month. It will prejudice the liquidity objective of the proposals if market-makers can effectively withdraw from the market for large periods, for instance two weeks in every four. It would not be difficult for each of the six market-makers to withdraw at the same time, thereby closing the market. New entrants and independent generators will require a continuous market. It will be preferable if the market is open during normal trading hours. We can support the adoption of specific trading windows, say suitable periods each morning and afternoon. We suspect that the arguments being put forward by potential market-makers to limit the periods during which they have to post prices are



being put forward in order to limit the potential volumes that they have to trade. A restriction on volumes will inevitably reduce effective liquidity.

## **Volumes**

Previously Ofgem's mandatory auction proposal was for 25% of the electricity generated by the parties now proposed to be market-makers. The trading of significant volumes is an important element of an effective market and reduces the scope for manipulation and gaming. In turn, significant volumes are an assurance that the reference price produced is genuine. We therefore believe that there should be no structural limit on the volumes which must be offered (for buying or selling) by the market makers.

We have a number of other more general points

The proposed market-makers have been arguing that there should be a restricted market-maker regime until this has established itself and that only then should Ofgem introduce a wider range of products, tighter bid offer spreads, less limited market volumes, and less restricted market operating times. This approach should be resisted. These initial limitations and restrictions are all ways of limiting the impact of Ofgem's suggested reforms and the proponents of these limitations seek to limit the scope for introducing effective liquidity into the market, which analysis has repeatedly shown to be lacking.

In recent public pronouncements the Government has recognised the need for new investment in gas generation in the near future. As a result Capacity Market auctions are due to be introduced as soon as 2014. The success of those auctions in promoting new investment will in part be dependent upon the existence of a liquid market giving potential bidders confidence that the UK has a genuine route to market for power generated. It is therefore important that a properly functioning and liquid wholesale electricity market is introduced in the same timescale by next year, and not in a piecemeal fashion which would just further delay new investment.

By concentration on identifying prices along the curve there is a danger that a mechanism is adopted that only identifies prices in a restricted manner and so does not foster greater liquidity generally. Identifying a reference price is not an end in itself but has been adopted by Ofgem as a good proxy and pre-requisite for greater liquidity. It is important that Ofgem is not persuaded into a mechanism which is designed to set a price and little more. Not only would the resultant price be less reliable, but the proposed reforms will fail to achieve the overarching aim of increasing liquidity and attracting new entrants into the generation market.

The impact assessment published at the same time as the latest consultation document, sets out potential costs of implementing the market-maker proposal. For the proposed market-makers these costs as a percentage of total turnover are minimal and will be significantly outweighed by the cost savings to consumers of effective liquidity and genuine competition. (The electricity industry was privatised with clear separation between generation and supply. The proposed market-makers have reaped enormous commercial advantage, at the cost of effective competition, by being vertically integrated. It would not be unreasonable to require the proposed market-makers to absorb these comparatively nominal costs themselves, without passing on the cost to consumers, given the huge commercial benefits they and their shareholders have enjoyed at the cost of effective competition.)

Carlton Power Limited is a UK based independent power station developer and has managed projects in the UK and Europe since the company was founded in 1995. To date, we have been involved with

the construction of over 1800MWs of installed electrical capacity and a further 2380MW of consented plants in the UK of which 860MW is currently under construction.

We look forward to further active stakeholder engagement with Ofgem as these proposals are developed further.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'David Philpot', with a stylized flourish extending to the right.

David Philpot  
Director and General Counsel