

## Statement by Eileen Marshall, Deputy Director General, Ofgem on NETA

- 1.1 The introduction of the new electricity trading arrangements (NETA) will mark a radical departure for the industry. It will deliver significant advantages over the present Pool-based wholesale trading arrangements. We believe that NETA will address many of the problems that, over the years, have been identified in relation to the operation of the compulsory Pool but it will not address all the problems. There will still remain scope for manipulation close to real time against which action is needed.
- 1.2 There are four main advantages that NETA should bring with regard to the scope for manipulation of prices.
- 1.3 **First, except close to real time, NETA should be less vulnerable to the abuse of market power.** Present trading arrangements have facilitated the exercise of market power at the expense of customers by enabling all generators to receive a uniform System Marginal Price. The new arrangements no longer compel generators to sell their output into the Pool and suppliers to purchase their requirements from the Pool. As a result of this new freedom, together with arrangements in the Balancing and Settlement process which

encourage contracting ahead, we expect that the forward, futures and short term power exchanges will become the main wholesale markets, where the vast majority of electricity will be traded and priced. Prices will be determined by real competition between buyers and sellers, including commodity traders.

1.4 **Second, NETA will strengthen the influence of customers on wholesale price formation.** The move away from a compulsory Pool to much greater reliance on bilateral contracting between generators and suppliers, coupled with the opportunity for the demand-side to participate directly in the Balancing Mechanism will significantly enhance the competitive pressures that the demand-side can bring to bear on the market.

1.5 **Third, NETA will be more flexible and adaptable to changing economic conditions.** One of the major criticisms of the Pool has been its slow pace of reform. Ofgem has given careful consideration to the new rules for the Balancing Mechanism and Settlement Process under NETA in order to minimise their complexity and to speed up the rules modification process once the new arrangements are introduced.

- 1.6 **Fourth, NETA will be more conducive to the effective monitoring of anti-competitive practices.** Pool prices are available day-ahead but very little information has been available generally with regard to contracts. Under NETA we expect greater price discovery and transparency and hence that overall market surveillance will improve. There will be price reporting from power exchanges and the Balancing Mechanism and we anticipate that more general reporting of bilateral trades will continue to develop.
- 1.7 While NETA will deliver more efficient and more competitive trading of electricity and a greater choice of markets and products to trade, the new trading arrangements will not solve all of the problems of the electricity market. Changing the trading arrangements cannot alter the physical and economic characteristics of the wholesale electricity market that render it vulnerable to the exploitation of market power 'close to real time'.
- 1.8 Thus, very close to real time market power is likely to remain a particularly intractable issue, as the System Operator seeks to balance an unbalanced supply and demand position very quickly. The problems of capacity withholding, complex rules, and of physical positions played off against contracts will all remain.

- 1.9 Capacity withholding is a particularly powerful form of manipulation under the Pool since modest changes in capacity availability can lead to large changes in Pool prices, but it will remain possible and potentially profitable for portfolio generators under NETA.
- Generators will be able to withhold capacity from either the forwards markets or the Balancing Mechanism or both. If enough energy is withheld from the forward markets, the system may be short of energy at the start of the Balancing Mechanism. The System Operator will thus have to purchase electricity and the generator manipulating the market will be aware of this fact and hence will offer to sell electricity at an inflated price in the Balancing Mechanism.
- 1.10 Although Ofgem has sought to simplify the Balancing Mechanism as far as practicable, the rules governing it are inevitably complex because they have to deal with balancing the system over very short timescales. Therefore, the potential for manipulating prices via bidding strategies that exploit the rules will remain.
- 1.11 To summarise, although we consider that NETA will provide more competitive wholesale trading arrangements, we expect a threat to the public interest from the abuse of substantial market power to persist even when the new electricity trading arrangements are

introduced. NETA is expected to make this problem less extreme than under the present Pool-based arrangements. But we are clear that it would be irresponsible to rely on NETA alone. The problem – and the harm it causes – will not be completely solved by NETA.

1.12 We therefore firmly believe that the inclusion of a market abuse condition in the licences of participants will remain necessary under NETA.