

Date

19 March 2003

Our Ref

Your Ref

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Dear Eileen

STANDARD GENERATION LICENCE CONDITION 18

We are pleased to have the opportunity to comment on this consultation.

Since SLC 18 was introduced, a number of new regulatory instruments have come into play. We now have the Competition Act prohibitions, the market abuse regime of the Financial Services Authority, and a modified Grid Code. Elements of these mutually strengthen one another, as our response (attached) shows, and in totality they have the same effect as SLC 18.

We therefore support the suggestion that SLC 18 be abolished in all generation licences. We believe that SLC 18 is unnecessary and discriminatory, and, while having little or no real effect, increases the regulatory complexity of operating in the generation sector.

The timeframe for disapplication procedures is lengthy, and, of the options summarised in Ofgem's document, we would prefer an early removal of SLC 18 from the licences by way of a licence modification. We are aware of the problems raised by the continuing absence of a statutory order from the DTI pursuant to section 11A(6)(b) of the Electricity Act. However, by virtue of the definition of 'relevant licence holder' under section 11A(10), the only persons entitled to object to a removal of the condition by way of a standard licence modification would be those generators in whose licences the provisions are currently operative. There must therefore be a high probability that Ofgem could remove the condition altogether by reference to section 11A(6)(a), which permits a modification to be made where no relevant licence holder objects, notwithstanding the absence of a DTI order.

It will be helpful if the assessment of responses to this consultation could be quicker than has been the case for the consultation on the self-supply restriction, which closed last July.

Yours sincerely

Denis Linford
Head of Regulation

Attachment

CONSULTATION ON ELECTRICITY GENERATION STANDARD LICENCE

CONDITION 18: GENERATING UNIT AVAILABILITY

We support the proposal that SLC 18 should either be disapplied in, or be removed from, all generation licences, as we believe that it:

- (a) is discriminatory between generators, and
- (b) adds to perceived regulatory complexity, but
- (c) has no real effect, since, in its absence, other means of regulation, in totality, would have the same effect.

There are a number of other regulatory levers which we believe have the same effect as SLC 18 in totality. They include the Financial Services Authority's market abuse regime, the Competition Act prohibitions, and the current form of the Grid Code. The FSA's regime strengthens the obligations for the accuracy of Grid Code OC2 information (as this is now published in condensed form). This was not mentioned in Ofgem's consultation document.

All generators are subject to a Grid Code chapter, OC2, which requires a range of detailed outage information to be provided to NGC on timescales that range from a couple of days to +52 weeks. The information has to be accurate according to the Grid Code itself, and is published to the market in a slightly condensed zonal form.

Clearly, both prohibitions of the Competition Act are also relevant. Ofgem can mount a dawn raid (as can the OFT) to get information from a company – which would be obliged to answer all questions and disclose written material if Ofgem had reasonable grounds for suspecting a contravention. The Competition Act empowers Ofgem, once it has decided that one of the prohibitions has been infringed, to give directions that the infringement should end, and to take immediate interim measures before (or while) it makes a proper investigation.

The most severe penalty for infractions of the Competition Act is a fine of up to 10% of the company's relevant turnover. There is also the possibility of third-party actions for damages. These features of the Act ensure that compliance with this legislation is taken seriously.

When the Competition Commission rejected Ofgem's proposal for a market abuse licence condition (MALC) in generation licences, its report made very clear that it had been strongly influenced by the generators' argument that the Competition Act was capable of addressing abuses, since there was 40 years' accumulated experience of the application of its principles in Europe and the Act required UK law to be consistent with Community law on competition issues. MALC was therefore seen as redundant, adding to perceived regulatory complexity without real, needed effect. By logical extension, the same must be true of SLC 18.

The FSA's market abuse regime, which does not apply only to FSA authorised firms, effectively strengthens the Grid Code. This is because it defines market abuse as behaviour which is likely to give a regular user of the market a false or misleading impression in various respects (including supply). Behaviour, if it is not to be abusive, must not fall below the standard of conduct that could reasonably be expected of a regular user. What is reasonable includes, clearly, compliance with the Grid Code, which states that the OC2 data must be accurate. This means that, if a generator's OC2 data are misleading, then that generator is misbehaving under the FSA's regime.

This is very significant because the penalty for such misbehaviour can be a very large fine and even criminal sanctions on the responsible parties. Recent serious examples have included a high street bank (£10m, February 2003) and ICE (£1m, August 2002).

We believe that, taken together, the provisions and requirements of the FSA regime, the Competition Act, and the Grid Code produce restrictive effects on generators comparable to those imposed by SLC 18. It cannot be efficient for the numerous operators in the sector to be affected by so many closely-related regulations where one is clearly redundant. It is common ground that perceptions of excessive regulation may deter future investment in the sector.

Of the options posed by the consultation paper, we would prefer the early removal of SLC 18 from all generation licences by way of a standard licence modification. We address this option in more detail in our covering letter.

London Electricity Group

March 2003