



To all stakeholders

*Promoting choice and value for  
all gas and electricity customers*

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Date: 22 June 2011

Dear Colleague,

### **Ofgem's Retail Market Review – update and next steps (liquidity proposals)**

This letter updates stakeholders on the process of Ofgem's Retail Market Review<sup>1</sup> (the Review) and the intended plan over the coming months<sup>2</sup>. At its board meeting on 16 June 2011, in light of responses to our consultation document, The Gas and Electricity Markets Authority authorised the Executive to proceed with the development of proposals for intervention aimed at improving the effective functioning of the retail energy markets. In our consultation document, we stated that if, following consultation, we consider that our proposed reforms do not have a realistic chance of addressing the concerns we identified due to industry opposition or otherwise, we will consider a referral to the Competition Commission. Given the responses we have received, our position on this remains unchanged at this stage: we are progressing work on our proposals and will keep this assessment under review.

In the Review we identified a static retail market structure, with one new entrant since the Probe. We also observed that liquidity in the GB power market was continuing to stagnate. We believe there is a link between power market liquidity, the ease of market entry and retail market competition. We therefore consider that low liquidity is a feature of the power market which puts consumers at risk. We also consider that a liquid and transparent wholesale market is beneficial to a healthy, competitive generation market which can make investment decisions on sound price signals.

We have always maintained that we would prefer to see industry initiatives deliver the required improvements. However, we are committed to take action in the event that insufficient or slow progress could be putting consumers at risk. The Review represented the third assessment carried out since we began our investigations into low liquidity in the GB power market<sup>3</sup>. Despite several positive developments, each assessment reveals limited progress. Today we publish our summer 2011 findings and these tell the same story.

*We recognise that intervention must be in the interests of consumers*

For any intervention to be successful, it must better enable a transparent market which meets participants' needs and those of potential new players. We continue to consider the

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<sup>1</sup> The Retail Market Review – Findings and initial proposals, 21 March 2011, Ref. 34/11

All related documents available here: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

<sup>2</sup> The focus of this letter is on Proposal 2: initiatives to enhance liquidity. The other proposals (Proposal 1: improving tariff comparability; Proposals 3 and 4 on strengthening protections and information requirements for customers introduced after the Energy Supply Probe in the domestic and non-domestic sectors respectively, and Proposal 5 on improving reporting transparency) are being progressed separately, to independent timelines.

<sup>3</sup> Liquidity in the Great Britain (GB) wholesale energy markets, 8 June 2009, Ref. 62/09

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=58&refer=Markets/WhlMkts/CompandEff>

activities of suppliers, generators and non-physical traders in determining what these needs are. To this end we have engaged in bilateral discussions and analysed responses to the consultation. We agree that any intervention should:

- 1) Align with what currently works well in the market.
- 2) Allow GB to evolve towards an integrated part of a wider European market.
- 3) Take account of potentially significant changes as a result of the Government's Electricity Market Reform proposals<sup>4</sup> and developments in EU legislation<sup>5</sup>.
- 4) Not incur significant cost in the event that it is not considered successful.

*We continue to believe that action is required to improve liquidity*

We acknowledge that it will take time to determine actions which meet the criteria set above. We do not want our work to develop these actions to be interpreted as a lack of commitment to make an appropriate intervention. We are making it clear now that, based on our latest full assessment, and our preliminary review of the responses to our consultation, we consider further development of our proposed interventions is appropriate.

We are therefore still minded to propose the introduction of a Mandatory Auction (MA) and Mandatory Market Making obligations (MMM). The rationale and design of these interventions is discussed in some detail in Supplementary Appendix Seven<sup>6</sup> to the Review. We indicated in that document and would reiterate here that any further decision will be subject to the results of a full impact assessment.

*We are working to develop our options*

As intended, the designs outlined in the Review have sparked constructive discussion. We recognise that key questions remain – in particular regarding the nature of any obligations; the platform on which any obligated products would sit; exactly what products would be supported; and how credit and collateral arrangements can best enable participation without unduly increasing market risk.

We anticipate working with you over the summer to establish how to address these key issues. We will consider whether a roundtable event could be helpful in this respect. We hope to publish our impact assessment, and our associated decision, towards the end of this year. This will allow any required implementation plan to commence as soon as possible in 2012, and with ongoing support we would expect significant progress by 2013.

Thank you for your continued engagement. If there is anything in this letter which you would like to discuss, please contact Camilla Egginton (email: [Camilla.Egginton@ofgem.gov.uk](mailto:Camilla.Egginton@ofgem.gov.uk), tel. 020 7901 7433).

Yours sincerely,

**Andrew Wright**  
Senior Partner - Markets

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<sup>4</sup> At the time of writing we are awaiting publication of the Government's White Paper. Initial details of the proposed reforms can be found in the December 2010 consultation document:

<http://www.decc.gov.uk/en/content/cms/consultations/emr/emr.aspx>

<sup>5</sup> Relevant initiatives include: REMIT, which will set out rules to deter market abuse in electricity and gas in wholesale markets and may require transaction reporting; EMIR, which may require mandatory clearing of OTC derivative contracts through exchanges and enhanced risk-management measures for OTC derivatives trades that cannot be cleared through exchanges; and the MiFID review. MiFID regulates trade in derivative instruments. Energy utilities are currently exempt from its scope but this may change.

<sup>6</sup> [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR\\_Appendices.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf)